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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1939

No. 23

THOMAS K. CASE AND ADELE B. COWAN, AND ESTATE OF ADELE B. COWAN, DECEASED, PETITIONERS,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.

No. 24

THOMAS K. CASE AND ADELE B. COWAN, AND ESTATE OF ADELE B. COWAN, DECEASED, PETITIONERS,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 28, 1939.

CERTIORARI GRANTED MAY 22, 1939.

SUPREME COURT OF THE UNITED STATES

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Names and Addresses of Solicitors.

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In propria persona,
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Los Angeles, California.

For Appellant Adele B. Cowan:

CLARKE & BOWKER, Esqs.,
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411 West Fifth Street,
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For Appellee Los Angeles Lumber Products Company, Ltd., a corporation:

FARIES & McDOWELL, Esqs.,
DAVID R. FARIES, Esq.,
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GIBSON, DUNN & CRUTCHER, Esqs.,
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STUART L. LAPP, Esq.,
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Los Angeles, California.

United States of America, ss:

THE PRESIDENT OF THE UNITED STATES OF AMERICA

To LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a Corporation, GREETING:

YOU ARE HEREBY CITED AND ADMONISHED to be and appear at a United States Circuit Court of Appeals for the Ninth Circuit, to be holden at the City of San Francisco, in the State of California, within thirty days from the date hereof, pursuant to an order allowing an appeal, of record in the Clerk's Office of the United States Circuit Court of Appeals for the Ninth Circuit, wherein THOMAS K. CASE and ADELE B. COWAN, are appellants, and you are appellee, to show cause; if any there be, why the decree or judgment rendered against the said appellants, as in the said order allowing appeal mentioned, should not be corrected, and why speedy justice should not be done to the parties in that behalf.

WITNESS, the Honorable CURTIS D. WILBUR, Senior United States Circuit Judge for the Ninth Judicial Circuit this 8th day of May, A. D. 1938.

CURTIS D WILBUR
Senior United States Circuit Judge.

RECEIPT of a copy of this original Citation on Appeal, in No. 8841 United States Circuit Court of Appeals, Ninth Circuit, is hereby admitted this 20th day of May, 1938.

Faries & McDowell by W. R. Hackett
Attorneys for Debtor and Appellee.

[Endorsed]: Filed R. S. Zimmerman, Clerk, at 46 min. past 1 o'clock May 20, 1938, p. m., By M. J. Sommer, Deputy Clerk.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

In the Matter of)	
)	No. 31352 RJ.
LOS ANGELES LUMBER)	
PRODUCTS COMPANY,)	In proceedings for the
LTD., a corporation)	Reorganization of a
)	Corporation.
Debtor.)	

ORIGINAL PETITION OF DEBTOR

TO THE HONORABLE JUDGES OF THE DISTRICT COURT OF THE UNITED STATES SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION:

The petition of Los Angeles Lumber Products Company, Ltd., a corporation, hereinafter referred to as the "Debtor", respectfully shows:

I.

That Debtor is a corporation organized under and existing by virtue of the laws of the State of California; that it is not a municipal, railroad, insurance or banking corporation or a building and loan association, but is a corporation which could become a bankrupt under section four of an Act of Congress entitled "An Act to Establish a Uniform System of Bankruptcy Throughout the United States" approved July 1, 1898 and acts amendatory thereof and supplemental thereto. Said Act of Congress and acts amendatory thereof and supplemental thereto hereinafter are referred to as the Bankruptcy Act.

The Debtor now has, and during the six months next preceding the date of filing this petition, and also for a long time prior thereto, has had its principal place of business and assets in the City of Los Angeles, County of Los Angeles, State of California; and is therefore within the territorial jurisdiction of the District Court of the United States for the Southern District of California, Central Division; and the interest of all parties would best be served by filing this petition in said territorial jurisdiction. Debtor's address is P. O. Box 231, San Pedro, California. The debtor has not been adjudicated a bankrupt and no proceeding involving the sequestration of its assets is pending in any court; the debtor is unable to meet its debts as they mature and desires to effect a Plan of Reorganization.

II.

That the nature of Debtor's business originally was the ownership of timber licenses, sawmills and property and equipment necessary for the operation of a sawmill and a lumber business. That Debtor ceased such business in 1925 and has since acted as a holding company, owning and holding all of the outstanding shares of the capital stock of the following corporations, excepting certain qualifying shares held by directors of said corporations:

1. Los Angeles Shipbuilding and Drydock Corporation, a corporation organized and existing under the laws of the State of California.

2. Masset Timber Company, Limited, a corporation, organized and existing under the laws of the Province of Canada.

3. Puget Sound Lumber & Box Company, a corporation organized and existing under the laws of the State of Washington.

4. Pacific Wirebound Box Company, a corporation, organized and existing under the laws of the State of California.

5. Western Marine Supply Company, a corporation, organized and existing under the laws of the State of California.

6. Los Angeles Lumber Products Steamship Company, a corporation, organized and existing under the laws of the State of California.

That as to said qualifying shares the beneficial ownership is vested in Debtor.

III.

In brief, Debtor's assets, other than the stock of said subsidiary corporations which is hereinafter treated separately, consist of:

(a)	Cash in bank	$ 1,187.27	
(b)	Accounts Receivable	5,199.50	(collectible)
(c)	Accounts Receivable	2,482,618.19	(inter-company accounts uncollectible)
(d)	Sinking fund account	3,070.48	

(e) Harbor leasehold (68.54 acres) upon which shipbuilding business is operated carried at nominal value on books.

And that the liabilities of Debtor consist of:

(a) $2,565,500.00 due and owing on its First Lien and Collateral Trust twenty year 7½% Sinking Fund Gold Bonds, hereinafter referred to as bonds, issued March 8, 1924, for the purpose of financing its lumber business, issued under and secured by

mortgage dated March 8th 1924, wherein Security-First National Bank of Los Angeles is named as Trustee.

(b) Approximately $1,241,571.88 interest accrued on said bonds since 1930, the last date upon which interest was paid.

(c) Accounts payable $6,075.94 (current).

(d) Due Los Angeles Shipbuilding and Drydock Corporation $496,899.76.

IV.

That the issued and outstanding capital stock of Debtor consists of 57,788 shares of Class A stock and 5,112 shares of Class B stock, both of said classes of stock having a par value of Ten Dollars ($10.00) per share.

That the difference between said Class A and Class B shares is that the Class A shares are entitled to a preference of $400,000, on liquidation, together with interest thereon from April 1st 1930, until paid, over the Class B shares, which amount shall be paid on account of said Class A shares before any amount shall be paid on account of Class B shares.

V.

That Pacific Wirebound Box Company, Western Marine Supply Company and Los Angeles Lumber Products Steamship Company have no tangible assets of any kind; that they have not operated since 1925 or thereabouts; that they represent an annual expense to Debtor and are of no value to the efficient operation of Debtor's business; that it is, therefore, highly desirable that those companies be dissolved; that leave will be asked of this Court to dissolve said corporations.

VI.

That Masset Timber Company, Limited, owns twenty-four licenses issued by the Government of the Province of British Columbia, Canada, comprising approximately 12,000 acres of timber land on Graham's Island in said British Columbia, Canada; that it owns in fee simple lots 1497, 1498 and 444, Queen Charlotte District, Province of British Columbia, whereupon are located certain buildings, wharves and docks. That the Masset Timber Company, Limited, has been to date a financial failure and a great expense to Debtor; that the present annual expense of carrying the said company's properties is $9,000.00. That competent appraisers familiar with Canadian timber have reported said properties as having no present market value. That a copy of said appraisal is filed herewith marked Exhibit "A" and made a part hereof that Debtor will ask the Court to determine what disposition should be made of the shares of stock of said company and its property.

VII.

That Puget Sound Lumber & Box Company owns certain real estate, buildings and wharves and docks, comprising the sawmill and box factory units located on Lake Union in Seattle, Washington; that said property has a water frontage of approximately 700 feet; that lumber operations at this plant have resulted in heavy losses; that because of these losses the property was closed down in 1925 and since that time has been almost completely dismantled; that the City of Seattle, which has extended its residential district to within short distances of the property, has zoned the property against a resumption of its former operations; that the sawmill, buildings, originally erected at great cost is specially constructed and

unfit for other purposes; that the water adjacent to the docks is of insufficient depth to permit commercial vessels of average draft to moor thereto for the discharging or loading of cargo; that said docks and piers are in need of extensive repairs, necessitating the expenditure of sums in excess of their worth.

That the property has value only as real estate; that competent appraisers have recently estimated this value at $25,000.00 to $40,000.00; that the annual expense of carrying this property is $3,500.00. That a copy of said appraisal is filed herewith marked Exhibit "B" and made a part hereof; that Debtor will ask the Court to determine what disposition should be made of the shares of stock of said company and its property.

VIII.

That Los Angeles Shipbuilding and Drydock Corporation is engaged in the shipbuilding and ship repair work at Los Angeles Harbor, San Pedro, California; that said corporation is hereinafter referred to as the Shipbuilding Corporation. That said asset constitutes the only asset of real substantial value and earning possibilities owned by Debtor. Said Shipbuilding Corporation occupies a 68 acre tract of real property owned by the City of Los Angeles on Smith's Island at San Pedro, California; that said property is leased to the Debtor and subleased by Debtor to the Shipbuilding Corporation; that said lease by its terms expires April 9th, 1952, at which time, under its provisions, all of the wharves, piers, docks, slips, bulkheads, seawalls and channels thereupon shall revert to and become the property of Lessor; that the work undertaken and completed in said shipyard has been of high quality, of great value to the Federal Government and

to the City; that in general said work has resulted in substantial operating profits to said Shipbuilding Corporation; that Debtor believes that a continuance of the said work will be of value to maritime commerce and in turn to the continued development of Los Angeles Harbor, the City of Los Angeles and the State of California.

That it is the opinion of Debtor that ship owners have and may in the future become more reluctant to intrust valuable vessels to said Shipbuilding Corporation when it is generally known that Debtor is in the financial condition set forth herein; that said ship owners have doubts as to the possibility of the prompt completion of the work undertaken and they may fear that the vessel under construction or repair might become involved in litigation.

That bonding companies, compelled by depression experiences to increase their requirements, are now likewise unwilling to assume the risk of becoming surety for said Shipbuilding Corporation with the bonds of Debtor in default; that without the ability to obtain these bonds the operations are of necessity restricted to small repairs, which, while profitable, can never under any circumstances, in the opinion of Debtor, be expected to produce sufficient earnings to liquidate Debtor's bonds, or even pay the interest thereupon.

IX.

That the American Appraisal Company, of national reputation, was employed to and did make an appraisal on a going concern basis of all of the assets of said Shipbuilding Corporation; that said Appraisal Company under date of October 21st 1936, rendered its report in detail showing said assets to have a going concern value as at said date of $465,000.00; that a copy of said appraisal

is filed herewith marked Exhibit "C" and made a part hereof.

X.

That the books of Shipbuilding Corporation were audited by Lybrand, Ross Bros. & Montgomery as of December 31st 1937. Said audit showed the company's financial condition on said date to be as follows:

Cash on hand	$230,129.20
Accounts receivable considered collectible	128,723.43
Inventories and work in process	75,560.53
Making a total of	$434,413.16

That by the terms of the original Trust Agreement the current assets of said corporation are specifically excluded from the lien of the bonds. That copies of said audits are filed herewith marked Exhibit "D" and Exhibit "E" and made a part hereof.

XI.

That said Shipbuilding Corporation is not primarily responsible for the payment of the bonds of Debtor, but the assets of the Shipbuilding Corporation, consisting of its lease, buildings and equipment, have been pledged and are included in the property covered by the Trust Indenture, as security for the payment of said bonds.

Over a period of many months Debtor has discussed with representatives of certain holders of its bonds a Plan of Reorganization either by way of a voluntary proceeding or under the provision of said Section 77B. As a result thereof, a Plan of Reorganization dated May 24th 1937 was agreed upon, which is hereinafter referred to as

the Plan, which the Debtor believes is fair and equitable and does not discriminate unjustly in favor of any class of creditors or stockholders of Debtor and is feasible.

That on February 13th 1937, application was made to the Commissioner of Corporations of the State of California for authority to submit said Plan to its bondholders and stockholders. That a hearing was had on said application on May 5th, 6th and 25th, 1937, and a finding was made that the Plan presented was fair and a permit was issued dated June 14th 1937, by said Commissioner authorizing the solicitation of bondholders for their approval of the said Plan. That a copy of said Plan which includes a copy of said permit is attached hereto marked Exhibit "F" and made a part hereof; that in accordance with said permit, Debtor has solicited its bondholders and stockholders.

That as of December 31st 1937, 80.67% of the holders of Debtor's bonds, representing $2,069,500.00 of said bonds have authorized the Security-First National Bank of Los Angeles as depositary to appear in this proceeding on their behalf and consent to said Plan.

That as of December 31st 1937, 98.35% of the holders of Class A shares of Debtor have authorized the Security-First National Bank of Los Angeles to appear in this proceeding on their behalf and consent to said Plan.

That as of December 31st 1937, 81.02% of the Class B stock of Debtor have authorized the Security-First National Bank of Los Angeles to appear in this proceeding and on their behalf consent to said Plan.

Briefly summarized, said Plan contemplates that a new corporation to be known as Los Angeles Shipbuilding and Drydock Company, hereinafter referred to as the New

Corporation, be organized and that it acquire all of the assets of Los Angeles Lumber Products Company, Ltd. and Los Angeles Shipbuilding and Drydock Corporation, Ltd. excepting the stock of Masset Timber Company, Ltd. and Puget Sound Lumber & Box Company, free and clear of liens and encumbrances.

It is proposed that the new corporation shall have an authorized capital of $1,000,000 consisting of one million (1,000,000) shares of a par value of One Dollar ($1.00) per share.

The said New Corporation shall issue 830,000 of said shares in exchange for all of the assets of said shipbuilding business. It is proposed that 230 of said $1.00 shares be transferred to the bondholders in exchange for each $1,000 of bonds. There are $2,565,500 in principal amount of bonds outstanding which will result in a transfer of 590,065 of the said shares to the bondholders. It it proposed that the balance of said 830,000 shares shall be distributed ratably to the present Class A shareholders. There are 57,788 Class A shares outstanding, which will result in the Class A shareholders receiving approximately 239,935 shares.

It is proposed that the balance of said authorized capital of the New Corporation shall be held by the New Corporation to be sold for cash for the purpose of providing new operating capital in the event it is required by the company.

It is proposed that the assets of the Masset Timber Company, Ltd. and Puget Sound Lumber & Box Company shall be liquidated and that the proceeds derived therefrom shall be divided ratably among the Class B shareholders who are the owners of bonds, said stock

having been distributed in payment of interest on said bonds in 1930.

Under the Plan it is proposed that the parent company and all subsidiaries shall be liquidated and dissolved.

All of the other creditors of Debtor shall be paid the amount of their claims in full in cash and are thus not affected by the Plan.

XII.

Debtor desires to propose and have this Court consider said Plan, and further desires this Court to determine and fix the time within which said Plan shall be accepted and confirmed, to fix and determine a reasonable time within which claims and interests of creditors may be filed or evidenced and after which no claims or interest may participate in the Plan, excepting on order for cause shown; and the manner in which such claims and interests may be filed or evidenced and allowed, and, for the purpose of said Plan and its acceptance, the division of creditors and stockholders into classes according to the nature of their respective claims.

XIII.

There are approximately 757 separate holders of said bonds and approximately 768 separate stockholders of Debtor. By reason of such facts the preparation of a statement showing what, if any, claims and shares of stock of Debtor have been purchased or transferred by those accepting said Plan after commencement or in contemplation of these proceedings, and the circumstances of such purchases and transfers, would be impracticable, and Debtor desires this Court to direct that such a statement be not filed.

XIV.

Debtor believes that the appointment of a Trustee to manage its estate would be impracticable, the only business of Debtor being the holding of the stock of its subsidiary companies. That none of the officers of Debtor are paid a salary and they have indicated a willingness to continue the management under this proceeding without fee. Therefore, to avoid expense and preserve continuity of management Debtor believes that it should be temporarily continued in possession of its estate until further order of Court under the provisions of Section 77B of the Bankruptcy Act and such terms and conditions as the Court may deem proper and that this will be for the best interests of the creditors and stockholders of Debtor.

That it is impracticable to give notice of a hearing on this petition; that Debtor be temporarily continued in possession of Debtor's estate to other persons interested herein, and Debtor is informed and believes, and therefore alleges that it will be for the best interests of its creditors and stockholders if an order be made determining that no notice of a hearing on said petition is required.

The names of Debtor's officers and the offices held by them respective, are as follows:

C. C. Spicer, President and Director
David R. Faries, Vice President and Director
W. W. Powell, Director
H. K. Bagley, Director
Milo A. Baker, Director
W. I. Hollingsworth, Jr., Director
Harry W. Watson, Director
J. B. Ingoldsby, Secretary
J. C. Argue, Assistant Secretary

XV.

At a meeting of Debtor's board of directors duly held prior to the filing of this petition, a resolution was duly adopted authorizing the signing, verification and filing of this petition. A true copy of said resolution is attached hereto marked Exhibit "F" and by this reference made a part hereof with the same force and effect as if set forth at length herein. That Debtor is informed and believes and therefore alleges that reasonable and adequate notice of the filing of this petition and the determination of the matters herein prayed for except the leaving of Debtor temporarily in possession of its estate, will be given if Debtor is directed to publish once a week for two consecutive weeks in the Los Angeles Daily Journal and to mail to all of its known creditors and stockholders the form of notice attached hereto and marked Exhibit "G" and made a part hereof.

WHEREFORE, Debtor prays that an order be made and entered herein:

1. Approving this petition as properly filed in good faith under Section 77B of the Bankruptcy Act.

2. Determining that no notice on this petition to temporarily continue Debtor in possession of Debtor's estate be given and temporarily continuing Debtor in possession of all its property and assets with power to continue operating its business, subject to control of the Court, pending the further hearing to determine whether to make permanent the order continuing Debtor in possession and fixing a date and prescribing the notice for such hearing.

3. Fixing the time and place for a hearing on the confirmation of said Plan and prescribing the notice of such hearing to be given.

4. Determining and fixing a reasonable time within which claims and interests may be filed or evidenced and after which no claim or interest may participate in the Plan, excepting on order for cause shown, and the manner in which such claims and interests may be filed or evidenced and allowed and determining for the purposes of said Plan and its acceptance, the division of creditors and stockholders into classes according to the nature of their respective claims and interests.

5. Directing that there need not be filed herein a statement showing what, if any, claims and shares of stock of Debtor have been purchased or transferred by those accepting the Plan after the commencement or in contemplation of the proceedings herein and the circumstances of such purchase or transfer.

6. Determining that holders of Debtor's bonds and Debtor's stock are the only creditors and persons whose claims and interests will be affected by the plan.

7. Authorizing the company to continue the solicitation of those security holders who have not consented to the Plan for their consent and approval of said Plan.

8. Granting an injunction against interferences with the properties, assets and business of the Debtor.

9. Granting such other and further relief, general and special as may be provided for in said Section 77B and other provisions of said Bankruptcy Act to which Debtor may be justly entitled.

Dated: January 26th 1938.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.

BY C. C. Spicer

President

FARIES & McDOWELL

BY J. Clifford Argue

STATE OF CALIFORNIA)
) ss
COUNTY OF LOS ANGELES)

C. C. SPICER being by me first duly sworn, deposes and says:

That he is the President of Los Angeles Lumber Products Company, Limited, a California corporation, Debtor, in the above entitled action and makes this verification on its behalf; that he has read the foregoing Original Petition of Debtor and knows the contents thereof; and that the same is true of his own knowledge except as to the matters which are therein stated upon information or belief, and as to those matters that he believes it to be true.

C. C. Spicer

Subscribed and sworn to before me this 26th day of January, 1938.

[Seal] Muriel P. Montgomery
Notary Public in and for the County of Los Angeles, State of California.

[Exhibits C, D, E and G omitted]

[EXHIBIT F.]

PLAN OF REORGANIZATION OF LOS ANGELES LUMBER PRODUCTS COMPANY LTD.

Dated: May 24, 1937

IMPORTANT

See Instructions Inside Front Cover

INSTRUCTIONS

1. Read the Plan of Reorganization.
2. Sign Letter of Transmittal in accordance with instructions found at the end of the Letter.
3. Mail the Letter of Transmittal to the Security-First National Bank of Los Angeles, in the enclosed self addressed envelope with all securities attached.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.

P. O. Box 231

San Pedro, California

June 21, 1937.

To the Bondholders and Stockholders of
Los Angeles Lumber Products Company, Ltd.:

Under date of April 21st, 1937, a communication was addressed to you respecting the public hearing before the Commissioner of Corporations, and having to do with the proposed reorganization of Los Angeles Lumber Products Company, Ltd. The hearing referred to was duly held on May 5th, 6th, 25th, 1937, at which time an opportunity was afforded all persons interested to express their ideas and recommendations.

We are now pleased to report further that the Commissioner, after hearing the plans and explanations concerning the necessity therefor, has acted favorably upon the application to permit solictation among both the stockholders and bondholders, for the purpose of obtaining their consent to the plan.

In connection with the issuance of the permit, a copy of which is attached hereto, all parties in interest should understand that the California Statutes prohibit the Commissioner from recommending any plan of reorganization coming under his jurisdiction. His duty is only to determine to his satisfaction, before he permits the plan to be circulated among the interested parties, that it is fair and just to those whose interests it will affect.

Also, as required by law, you will find enclosed herewith, in complete detail, the proposed plan and necessary amendment to the Trust Agreement.

In order that those who were unable to attend the hearing may have as comprehensive an understanding of the situation as is possible to present in letter form, we have prepared the following brief explanation of the proposed plan. No attempt has been made to do more than set forth a broad view of the problems now confronting those who have money invested in Los Angeles Lumber Products Company, Ltd. securities, whether evidenced by bonds or stock.

Like many investments, Lumber Products bonds have suffered primarily from changed conditions, largely resulting from the depression. It is, therefore, easy to look backward and criticize policies of management and methods of production which may well have been profitable in 1923, but which anyone knows will result in deficits if

attempted in 1937. Assets which were formerly of value are now liabilities.

In 1930 an attempt was made to reorganize the company's affairs. Over ninety-seven per cent of the bondholders deposited their bonds as evidence of their approval of the program, and the stockholders, in like spirit, advanced a sum of $400,000.00 cash, to be used for working capital, and an additional $100,000.00 represented by liquid inventory. Here again, as in thousands of other industrial situations, the severity of the depression was under-estimated. Bonding companies that had formerly clamored for the company's business on almost any reasonable basis found themselves confronted with losses. These necessitated an entire readjustment of their requirements from contracting companies such as Los Angeles Shipbuilding and Drydock Corporation when issuing the necessary bid and performance bonds in connection with new ship construction. We are, therefore, face to face with these facts:

(1) The timber located on Graham's Island is, on today's market, an apparent liability.

(2) The sawmill and box factory at Seattle has been zoned by the City of Seattle so that it can no longer be used for our purposes and now appears to have only a limited value as real estate.

(3) The Shipbuilding Corporation at San Pedro, which is the only producing unit, is on leased ground from the City of Los Angeles, with fifteen years yet to run.

(4) There are over eight hundred widely scattered bondholders, with over 97% of their bonds deposited in trust on an income basis and with foreclosure remote.

(5) There are now outstanding approximately five times par value of bonds above the assets securing them,

according to figures compiled recently by competent appraisers.

(6) The working capital fund, accounts receivable, inventory and some equipment are expressly exluded from the lien of the bonds, by the terms of the original trust agreement of 1924.

In the light of these facts two alternative courses of action have logically presented themselves for consideration:

(1) We can continue the ship repair business as in the past and reasonably expect to realize sufficient profit therefrom to carry the northern properties on a non-operating basis, as required by the terms of the Trust Agreement, but cannot expect to do any substantial building of new ships, nor pay any substantial return on our present capitalization; or

(2) We can decide upon an equitable basis of reorganization for the company, as outlined in the attached plan.

In connection with the first alternative, much has been spoken to and among bondholders regarding the personal liability of certain prominent stockholders by reason of their waiver of the Statute of Limitations with respect to the bond issue. It is only fair to those so involved to point out that the California stockholders liability law has now been repealed by vote of the people. Furthermore, most of these stockholders who had weathered the depression and were financially responsible were released from their liability in 1930, on account of their advancing money to the company's working capital fund; also, the first Bondholders Committee, composed of impartial underwriters,

after a careful study of the particular situation, and upon advice of competent counsel employed by them, concluded that any attempt to reimburse bondholders through legal action against stockholders would, if it could be financed, prove disappointing and highly detrimental to the company's worth as a going concern. Therefore, with the possibility of recovery from stockholders under their old liability very remote, and with new ship construction made practically impossible, largely by reason of the outstanding bonds, the only remaining hope, under the first alternative, is a sale of the properties or an ultimate dissolution of the properties.

It should be elementarily clear that no prospective investor can be expected to become interested in joining in an enterprise so involved by complications with which he is totally unfamiliar and showing an indebtedness of five times its assets.

With respect to the liquidation of the properties, it must be equally evident to even the most uninformed that, while the assets have a real value on a going concern basis, the amount that could be realized from their sale, particularly in the light of their more or less obsolete nature, would return only a very small percent of their appraised value, and in all probability, a lesser amount than the present market price of the bonds.

In a letter addressed to bondholders under date of November 12, 1935, reference was made to litigation then pending against the company, whereby two stockholders were seeking the return of money that they had sub-

scribed and paid for Class "A" stock, in connection with the 1930 reorganization. It was the hope of attorneys in the case that, had it been brought to trial and judgment obtained as prayed for, it would have placed all Class "A" stockholders in a position to force the return of their money, thereby leaving the company without working capital. However, because of the cancellation of the Armes agreement, and to clear the way for the adoption of the present plan, the plaintiffs in that action have dismissed their suit.

Under the second alternative, or plan submitted herewith, the control of the company would pass into the hands of the bondholders by the issuance to them of more than 50% of the outstanding new stock. It will preserve for the company its working capital, which is vital to a continuance of the business. It will place the organization in a position to compete for new ship construction, and thereby open the way for rehabilitation and profits. Furthermore, it will give to the bondholders the entire proceeds realized from the liquidation of the northern properties and is in line with what has been successfully accomplished by hundreds of other industrial concerns throughout the nation and in accord with the inevitable upward trend of shipbuilding activities in the United States.

In the light of the foregoing we sincerely invite from you a fair and open-minded consideration of the problems confronting us in the Los Angeles Lumber Products tangle. Should you conclude, as we have done after months of intensive study and a careful analysis of the dis-

interested and impartial audits and appraisals recently completed, that the proposed plan presents the most promising compromise program available, we will appreciate your signing, before a Notary, the necessary papers enclosed herewith.

You will be reimbursed for your notary fees by having the Notary indicate the amount charged on the enclosed slip, which you should then attach to the executed papers you are forwarding to the Trustee, Security-First National Bank of Los Angeles, Sixth and Spring Streets, Los Angeles.

It is felt that the subject before us has been very fully covered, but should any questions present themselves which have not been subsequently explained, we will be pleased to have you address Mr. David R. Faries, 417 South Hill Street, Los Angeles, California, who will be pleased to furnish the information desired.

In closing may we urge upon you the advisability of giving this matter your prompt and sincere attention.

Very truly yours,

C. C. Spicer,
David R. Faries,
W. W. Powell,
Milo A. Baker,
H. W. Bagley,
W. I. Hollingsworth,
Harry W. Watson,
Board of Directors.

May 24, 1937.

THE PLAN

To the Bondholders and Stockholders of
Los Angeles Lumber Products Company, Ltd.:

Dear Sirs:

The following is submitted to you by your Board of Directors as a plan for the reorganization of Los Angeles Lumber Products Company, Ltd., including as part thereof a plan of reorganization of Los Angeles Shipbuilding and Drydock Corporation:

(1) Brief Statement of Plan and Recommendation of Board of Directors.

The Board of Directors, elected in June, 1936, proposes and recommends that the Los Angeles Lumber Products Company, Ltd. and its subsidiaries be reorganized along the line set forth herein in detail.

We propose that a new corporation, to be known as Los Angeles Shipbuilding and Drydock Corporation, be organized and that it acquire all of the assets of Los Angeles Lumber Products Company, Ltd. and Los Angeles Shipbuilding and Drydock Corporation, excepting the stock of the Masset Timber Company, Limited, and Puget Sound Lumber & Box Company, free and clear of liens and encumbrances. It is proposed that the new corporation shall have an authorized capital of $1,000,000.00, consisting of 1,000,000 shares of a par value of $1.00 per share.

—Exhibit "1"—

We propose that 830,000 of these shares be transferred to the bondholders and Class "A" shareholders in exchange for their bonds and Class "A" shares. It is our

suggestion that 230 of said $1.00 shares be transferred to the bondholders in exchange for each $1,000.00 of bonds. There are $2,565,500.00 in principal amount of bonds outstanding and this will result in a transfer of a total of 590,065 of said shares to the bondholders. We suggest that the balance of said 830,000 of $1.00 par shares be divided ratably in exchange for Class "A" shares. There are 57,788 Class "A" shares outstanding and this will result in Class "A" shareholders receiving approximately a total of 239,935 of said shares for all Class "A" shares.

We propose that 170,000 shares be held by the new corporation to be sold for cash for the purpose of providing new operating capital, which will be required by the new company to become an efficient unit in the shipbuilding business.

There are 5,112 shares of Class "B" stock of the company issued and outstanding. Said shares were issued to bondholders who deposited under the agreement of April 1, 1930 in payment of interest and virtually all of said shares are now held with the trust certificates. It is proposed that Class "B" shares shall be deposited and shall not participate in the stock of the new corporation other than the consideration which they will receive as bondholders.

Under this plan of reorganization the parent company and all subsidiaries shall be liquidated and dissolved. This will result in a considerable saving to the company in franchise taxes, salaries and other corporate expenses. The liquidation of the holdings of Masset Timber Company, Limited, and Pudget Sound Lumber & Box Company will also save additional expenses, all of which are set forth in detail in this plan.

Your Board of Directors has made a thorough study of the problems of the Los Angeles Lumber Products Company, Ltd., and its subsidiaries and is convinced that the company cannot expect to do business on a profitable basis under its present corporate and financial structure. We feel, however, that the company, when reorganized, will be in a position to successfully compete for new ship construction.

The plan herein proposed has been formulated from information obtained through an appraisal of the assets of Los Angeles Lumber Products Company, Ltd. and its subsidiaries, especially through an appraisal of the assets of Los Angeles Shipbuilding and Drydock Corporation by the American Appraisal Company, a nationally known firm of appraisers, from the audit of the books of the company made by Lybrand, Ross Bros. & Montgomery, a nationally known firm of accountants, and from opinions furnished by tax experts and legal counsel.

It is proposed that, upon completion of the plan, the balance sheet of the new corporation shall be approximately as shown on the proposed "new company pro forma consolidated balance sheet," attached hereto as "Exhibit A".

That a statement classifying shareholders and bondholders according to their holdings and showing ultimate conversions into stock of the new corporation is attached hereto as "Exhibit I".

All of the assets of Masset Timber Company, Limited, and Puget Sound Lumber & Box Company shall be liquidated and the proceeds derived therefrom distributed to the bondholders on a pro rata basis.

(2) Introductory Statement.

Los Angeles Lumber Products Company, Ltd. is a corporation organized under and existing by virtue of the laws of the State of California. It is the owner of all of the outstanding capital stock, excepting certain qualifying shares, of the following affiliated subsidiary companies:

Los Angeles Shipbuilding and Drydock Corporation

Masset Timber Company, Limited

Puget Sound Lumber & Box Company

Pacific Wirebound Box Company

Western Marine Supply Company

Los Angeles Lumber Products Steamship Company

Masset Timber Company, Limited, Puget Sound Lumber & Box Company, Pacific Wirebound Box Company, Western Marine Supply Company, and Los Angeles Lumber Products Steamship Company discontinued doing business in 1924 and 1925, and have been non-operative since that time.

Pacific Wirebound Box Company, Western Marine Supply Company and Los Angeles Lumber Products Steamship Company have no assets of any value.

Masset Timber Company, Limited, is the owner of certain timber licenses at Buckley Bay, which are being maintained at an annual cost of $9,000.00. An appraisal of these properties recently made indicates that they have little or no present value on today's market.

Puget Sound Lumber & Box Company is the owner of certain real estate on Lake Washington in Seattle, which is being maintained at an annual cost of approximately $3,500.00. An appraisal of these properties indicates that

they are no longer usable for lumber purposes and that their value as real estate is below $50,000.00.

The annual cost of maintaining the parent company, Los Angeles Lumber Products Company, Ltd., as a separate corporate unit, is approximately $9,000.00.

The present Los Angeles Shipbuilding and Drydock Corporation is the only operating company of the group. It has operated a drydock and ship repair plant since 1918 in the west basin of Los Angeles Harbor. The plant is located on a tract of land of approximately 68.54 acres, leased from the Board of Harbor Commissioners of the City of Los Angeles. For the past several years all of the earnings of Los Angeles Shipbuilding and Drydock Corporation have been from ship repair work. The company has not had the necessary working capital to finance new ship construction and due to the lien of the bond issue on its assets, has not been able to obtain bid and performance bonds for the purpose of bidding on new construction. The result of the company's operations, as reflected by its books of account since 1932, has been as follows:

	Gross Revenue	Cost of Sales and Operating Expense	Net Profit Before Depreciation
1932	481,639.76	495,374.67	13,734.89*
1933	579,261.23	500,916.93	78,344.30
1934	601,138.90	517,757.68	83,381.22
1935	682,056.94	619,611.49	62,445.45
1936	486,142.87	490,796.37	4,653.50*

*Indicates loss.

In connection with the 1936 figures it must be remembered that the Company suffered a six weeks strike early in the year and a thirteen weeks strike from November 14, 1936, which has just been settled.

Los Angeles Lumber Products Company, Ltd. on March 8, 1924, issued its First Lien and Collateral Trust Twenty-year Seven and One-half Per Cent. Sinking Fund Gold Bonds and the principal amount of $2,565,500.00 of said bonds is still outstanding. Said bonds are a lien upon the lease, buildings and machinery at Los Angeles Harbor in San Pedro and upon the stock of the Masset Timber Company, Limited and Puget Sound Lumber & Box Company and certain of their property holdings. Said company also has issued and outstanding 57,788 Class "A" and 5,112 Class "B" shares. The only difference between said shares is that Class "A" are entitled to a preference of $400,000.00 on liquidation, together with interest thereon from April 1, 1930, until paid.

In 1930 the Trust Indenture, under which said bonds were issued, was amended by the written consent of in excess of three-fourths of all bonds then outstanding. By the terms of said amendment it was provided that the default on account of non-payment of interest should be waived, and that interest coupons should not be enforceable until the maturity of said bonds in 1944. Said bonds have sold on the market for as low as $6.00 per $100.00.

In 1930 a change in the management of the Los Angeles Shipbuilding and Drydock Corporation and Los Angeles Lumber Products Company, Ltd. was had. At the suggestion of the underwriters and certain of the bondholders, George A. Armes was placed in charge of the companies at an annual salary of $24,000, under a contract which extended to April 1, 1940.

During 1936 two committees, one representing the bondholders and the other the shareholders, were organized for the purpose of securing a change in the management and recommending a plan for the reorganization of the com-

pany. These committees succeeded in effecting the change in management by securing a cancellation of the George A. Armes contract and by the reorganization of the Board of Directors and the electing of new officers. The new Board of Directors, elected in June, 1936, consists of two members who are representatives of bondholders, two new prominent shareholders, and three former Board members.

This new Board obtained an appraisal of the Los Angeles Shipbuilding and Drydock Corporation's assets by the American Appraisal Company. The values set up in the appraisal report are on the basis of a going concern and are not liquidation values. The appraisal includes the leased premises at Los Angeles Harbor, buildings, machinery, equipment and office furniture located thereon. All of these assets are pledged as security for the bond issue. A value of $465,000.00 was placed upon these assets by said appraisers. Due to the volume of the report, it is not attached hereto, but is available to interested parties at the company's office.

The audit of the books of the company by Lybrand, Ross Bros. & Montgomery indicates other assets (representing working capital, which includes, cash, accounts receivable, materials and supplies, etc.) of $365,203.23. These assets are not directly subject to the bond issue. The total assets of the Los Angeles Shipbuilding and Drydock Corporation are in the approximate sum of $830,203.23.

(3) Method of Consummation of Plan.

The plan shall be consummated under one of the two methods hereinafter set forth. It is intended that the final result under either method shall be the same. The first plan, if used, shall be accomplished by the consent of the parties, the second by a court proceeding. The Board of

Directors shall decide which of the two plans shall be followed. The decision of the Board of Directors on the method to be used will be made after the bonds have been deposited. It is contemplated that Security-First National Bank of Los Angeles shall act as Trustee under either method and that there shall be but one Trustee.

FIRST METHOD

It is proposed to follow this method in the event the Board of Directors shall deem that sufficient approvals have been obtained. This plan contemplates an amendment of the Trust Indenture or the execution of a new Trust Indenture, and the recapitalization of Los Angeles Lumber Products Company, Ltd. by the consent and approval of bondholders and shareholders.

(1) Under the plan it is proposed to exchange for all outstanding bonds new Class "A" shares of Los Angeles Lumber Products Company, Ltd., with a preference, in the event of liquidation, over Class "B" shares. The shares issued hereunder shall not be delivered to the bondholders, but shall be held by the Trustee for the benefit of the bondholders to be later exchanged for shares of the new company. In order to do this it is necessary to increase the authorized Class "A" shares of Los Angeles Lumber Products Company, Ltd. from 57,788 shares to 200,000 shares, so that there shall be shares available for exchange.

(2) When said new Class "A" shares are available, a supplemental trust indenture or a new indenture shall be executed by the company and Trustee, with the consent of the bondholders, providing for the cancellation of all outstanding bonds and the exchange of Class "A" shares of Los Angeles Lumber Products Company, Ltd. therefor.

Under this exchange the Trustee shall receive 142,032 of said Class "A" shares for the benefit of bondholders.

(3) Present Class "A" shareholders of Los Angeles Lumber Products Company, Ltd. shall also exchange their Class "A" shares for the new Class "A" shares. Under this exchange a total of 57,788 shares shall be exchanged for the present Class "A" shares and shall be issued to and be held by the Trustee for the benefit of the owners, subject to the terms of the plan of reorganization.

The next step in the plan shall be the dissolution of Los Angeles Shipbuilding and Drydock Corporation.

(1) When the Class "A" shares have been issued on the basis hereinbefore mentioned, the assets of Los Angeles Shipbuilding and Drydock Corporation shall be transferred to the Los Angeles Lumber Products Company, Ltd., it being the only shareholder, thereby consolidating all assets in Los Angeles Lumber Products Company, Ltd., and will allow the immediate dissolution of Los Angeles Shipbuilding and Drydock Corporation.

The plan then contemplates a reorganization of Los Angeles Lumber Products Company, Ltd. through a new corporation.

(1) When the assets have all been consolidated in the Los Angeles Lumber Products Company, Ltd., and the bonds exchanged for Class "A" shares, a new corporation shall be formed, to be known as Los Angeles Shipbuilding and Drydock Corporation. This corporation shall have an aggregate capital stock of 1,000,000 shares of $1.00 par stock all of one class.

(2) The new corporation shall issue 830,000 shares of its stock for the operating assets of Los Angeles Lumber Products Company, Ltd., free and clear of all encumbrances.

(3) When the assets have been transferred to the new corporation and its shares issued to Los Angeles Lumber Products Company, Ltd., Los Angeles Lumber Products Company, Ltd. shall be dissolved and liquidating dividends paid to its shareholders as follows:

(a) To the present bondholders who by the exchanges hereinbefore set forth, will own approximately 142,101 shares of the Class "A" stock of Los Angeles Lumber Products Company, Ltd., 230 shares of the stock of said new corporation for each $1,000.00 bond which will result in the bondholders receiving a total of approximately 590,065 shares of said new corporation.

(b) To the present Class "A" shareholders, who by the exchanges hereinbefore set forth shall hold approximately 57,788 shares of the Class "A" stock of Los Angeles Lumber Products Company, Ltd., the balance of the 830,000 shares of the new corporation, to-wit, 239,935 shares, which is the amount remaining after deducting the shares to be distributed to the bondholders, to be distributed ratably in exchange for their Class "A" shares.

The above mentioned transfers shall be made in accordance with the preference of said Class "A" shares over Class "B" shares.

Disposition of Certain Non-operating Assets.

(1) The next step in the reorganization shall be the liquidation of the Masset Timber Company, Limited, and Puget Sound Lumber & Box Company holdings. The shares of these companies shall be held by Los Angeles Lumber Products Company, Ltd. for the benefit of its bondholders. The new corporation shall loan sufficient funds to pay the cost of maintaining said properties.

until they are liquidated, the amount to be loaned to be at the discretion of the Board of Directors of the new corporation. Upon liquidation the funds derived therefrom shall be distributed in the following manner:

(a) To repay to the new corporation all advances, together with interest thereon at the rate of 6% from the date of such advance.

(b) To pay to former bondholders the balance thereof ratably.

SECOND METHOD

In the event an insufficient number, in the opinion of the Board of Directors, of bondholders and shareholders agree to the first method, then the Board of Directors may, in their own judgment, proceed under the provisions of Section 77-B of the National Bankruptcy Act. It is not the intention of the Board of Directors to go to this expense unless it becomes necessary by reason of the insufficiency of approvals of the first method, or unless for legal reasons it shall be later determined that such a proceeding would be for the best interests of the company and its security holders.

(1) In the event the Board of Directors of the corporation deems that the reorganization shall be consummated through a 77-B proceeding, or in the event such a proceeding is otherwise instituted, the depositary, or such other person as the Court may direct, shall file a claim or claims on behalf of all deposited bonds and on behalf of all deposited Class "A" and Class "B" shareholders, and shall consent to the transfer of all of the assets of Los Angeles Shipbuilding and Drydock Corpo-

ration to the new corporation in exchange for 830,000 shares of its $1.00 par capital stock. Said 830,000 shares of the stock of said new corporation shall be transferred to the bondholders and Class "A" shareholders in the following manner:

Each bondholder shall receive 230 shares of said stock for each $1,000.00 of bonds owned. The balance of said 830,000 shares shall be distributed ratably to the present Class "A" shareholders. This will mean that the bondholders shall receive approximately 590,065 shares of said stock and the Class "A" shareholders shall receive approximately 239,935 shares.

The Masset Timber Company, Limited, and Puget Sound Lumber & Box Company properties shall be liquidated and the net proceeds derived therefrom shall be distributed ratably among bondholders.

(4) Management.

It is contemplated that the Board of Directors of the new corporation shall be the present Board of Los Angeles Lumber Products Company, Ltd. until such time as the shareholders shall elect their successors.

(5) Method of Accepting and Becoming a Party to the Plan.

Letters of transmittal in appropriate form shall be prepared providing for the deposit of all bonds, certificates of deposit, Class "A" and Class "B" shares, with the Security-First National Bank of Los Angeles, who

shall be the depositary. All parties who are to participate in the plan shall be furnished a copy of this plan of reorganization. Holders of bonds, certificates of deposit, Class "A" and Class "B" shares, shall execute the appropriate letter of transmittal and forward the same, together with bonds with all coupons attached maturing since February 1, 1929, or certificates of deposit, or Class "A" or Class "B" share certificates attached, to Security-First National Bank of Los Angeles, Sixth and Spring Streets, Los Angeles, California. Security-First National Bank of Los Angeles shall, upon receipt of said letter of transmittal, properly executed and with proper attachments, execute and mail or deliver a receipt or certificate of deposit to each depositing party.

(6) Supervision of the Plan.

The Board of Directors shall have supervision of the consummation of the plan; subject, however, to the approval of the Court in the event a proceeding is instituted under the provisions of Section 77-B of the National Bankruptcy Act and shall have all of the authority, powers and rights which they deem necessary to put said plan into effect.

Without limiting the generality of the foregoing, the Board of Directors shall also have the powers, subject to the provisions of the plan and the approval of the Commissioner of Corporations of the State of California and the Court, in the event of a 77-B proceeding, to determine the form of securities, certificate of incorpo-

ration and by-laws of the new company, and any and all other documents and instruments used in connection with the reorganization.

All parties accepting the plan shall thereby be deemed to have authorized the Board of Directors to take all such steps and actions the Board of Directors shall deem necessary or desirable to carry out the plan in accordance with its terms and subject to the provisions of Section 77-B of the National Bankruptcy Act, in the event of such a proceedings.

The Board of Directors shall endeavor to carry out the reorganization in accordance with the plan and subject to the supervision of the Court in the event of a 77-B proceeding, but do not assume any personal liability in connection with carrying out the plan, except to exercise good faith in such endeavor.

The new company shall hold the members of the Board harmless from any expense in connection with the plan, except in the event they fail to use good faith in connection therewith.

Each party in interest accepting or becoming bound by the plan does so with the understanding set forth above and with the further understanding that the Board of Directors is acting solely as the agent of such party or parties in interest in an endeavor to carry out the reorganization in accordance with the plan, and as such agent shall have only the powers and duties expressly conferred by the plan, without prejudice, however, in any manner

to any discretion conferred by the plan upon the Board of Directors with respect to the means or methods of carrying out the plan, or otherwise.

The plan describes in general outline the method of effecting the reorganization, but the detailed provisions and steps to be taken to carry out the plan are necessarily to be determined in accordance with the powers granted by the plan and under the supervision of the Court, in the event of a 77-B proceeding, to fit the circumstances as they may exist from time to time during the reorganization.

(7) Modification of Plan.

In the event of a 77-B proceeding, changes and modifications in the plan may be made in the manner provided under Section 77-B of the Bankruptcy Act, subject to any right of withdrawal approved by the Court which any party in interest may have under any agreement, and subject to any other right of withdrawal which may be given by the Court by order or decree.

(8) Reorganization Expense.

All expenses of reorganization and all costs of administration and, in the event of a 77-B proceeding, any other allowances made by the Court, whether in an equity proceeding or in the reorganization proceeding, shall be paid in cash by the new company or out of the estate, as part of the consideration for the acceptance and approval of the plan.

Without limiting the generality of the foregoing, such expenses, costs, and allowances shall include reasonable compensation for the services rendered and reimbursement for the actual and necessary expenses incurred in connection with the reorganization and the preparation and consummation of the plan by officers, depositaries and the attorneys for the company, and in addition to the above, in the event of a 77-B proceeding, shall include reasonable compensation for services rendered by parties in interest, Trustee, depositary and representatives of bondholders and shareholders, and the attorneys or agents of any of the foregoing, all as shall be fixed, determined or approved by the Court. All such amounts to be paid for services or expenses incident to the reorganization shall be subject to the approval of the Board of Directors, and in the event of a 77-B proceeding, to the approval of the Court.

(9) Notices Under the Plan.

In the event of a 77-B proceeding, whenever notice shall be required or permitted to be given under or pursuant to the plan, such notice shall be given by publishing a copy thereof once in each week for two successive weeks in a newspaper of general circulation in Los Angeles, and in such other manner, if any, as the Court may direct.

(10) Statements Contained in the Plan.

The opinions, computations, assumptions, estimates, conclusion and statements contained in the plan, (1) are based upon or formulated from information obtained from

the books of the company and from the appraisers and auditors and other sources; (2) are submitted without warranty on behalf of the new company and are not made, joined in or admitted by the Trustee, or any committee, or any other party; (3) are made solely for the purpose of assisting the creditors and other parties in interest in making determination as to the fairness of the plan, and in the event of a 77-B proceeding, for the purpose of assisting the Court in making such a determination; and (4) are not intended for the use or information of prospective purchasers of new securities, referred to in the plan, or for any purpose other than the purpose stated above, and no one is authorized to make any statement regarding the plan, whether with reference to any securities referred to therein or otherwise, which is not set forth herein.

Information regarding Los Angeles Lumber Products Company, Ltd., and its subsidiaries is on file at the office of the company and may be examined on request.

Very truly yours,

C. C. Spicer,
David R. Faries,
W. W. Powell,
Milo A. Baker,
H. K. Bagley,
W. I. Hollingsworth,
Harry W. Watson,
Board of Directors.

BEFORE THE DEPARTMENT OF INVESTMENT, DIVISION OF CORPORATIONS OF THE STATE OF CALIFORNIA

In the matter of the application of LOS ANGELES LUMBER PRODUCTS COMPANY, LTD. for a permit authorizing them to issue Certificates of Deposit.	PERMIT File No. LA 1024 Receipt No. LA 21434

THIS PERMIT IS ISSUED UPON THE EXPRESS CONDITION THAT A TRUE COPY OF THIS PERMIT BE GIVEN TO THE DEPOSITOR PRIOR TO THE ISSUANCE OF CERTIFICATES OF DEPOSIT.

THIS PERMIT DOES NOT CONSTITUTE A RECOMMENDATION OR ENDORSEMENT OF THE SECURITIES TO BE ISSUED, BUT IS PERMISSIVE ONLY.

THIS PERMIT DOES NOT SIGNIFY THE APPROVAL OF ANY PLAN OF REORGANIZATION, BUT IS PREDICATED UPON A FINDING THAT THE TERMS AND CONDITIONS OF THE PROPOSED ISSUANCE OF CERTIFICATES OF DEPOSIT ARE FAIR.

NO OTHER SECURITIES, EXCEPT THE CERTIFICATES OF DEPOSIT HEREIN AUTHORIZED, MAY BE ISSUED UNLESS AND UNTIL A FURTHER PERMIT IS GRANTED BY THE COMMISSSIONER OF CORPORATIONS.

Applicant filed its application for the issuance and exchange of securities as hereinafter set forth on the 13th

day of February, 1937, and its amended application on the 1st day of June, 1937. Hearings were held on the 5th, 6th and 25th days of May, 1937, upon the fairness of the terms and conditions of such issuance and exchange, at which hearings all persons to whom it is proposed to issue securities in such exchange had the right to appear, and thereafter on the 14th day of June, 1937 the Commissioner of Corporations made and filed his findings of fact and conclusions, which are incorporated herein by this reference.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a California corporation, is hereby authorized to issue its securities as hereinbelow set forth:

1. To solicit the deposit of its First Lien and Collateral Trust Twenty-Year Seven and One-half Percent Sinking Fund Gold Bonds and of Certificates of Deposit representing said bonds, and to cause the issuance in exchange therefor, of Certificates of Deposit or Deposit Receipts, in the manner, on the basis, and for the uses and purposes recited in its application, as amended, for this permit.
2. To solicit the deposit of its Class A and Class B shares, and to cause the issuance in exchange therefor, of Certifictaes of Deposit or Deposit Receipts, in the manner, on the basis, and for the uses and purposes recited in its application, as amended, for this permit.

This permit is issued upon each of the following conditions:

(a) That the certificates of deposit and the deposit agreements shall, respectively, be substantially in the

terms, tenor and effect as the copies of such documents on file in the office of the Commissioner of Corporations, as amended.

(b) That unless revoked, suspended or extended by alteration or amendment, upon application filed on or before the date of expiration specified in this condition and upon such terms and conditions as the Commissioner may deem proper, all authority to issue Certificates of Deposit under issuance Clauses 1 and 2 of this permit shall terminate and expire on the 3rd day of June, 1939. All other issuance clauses and/or conditions of this permit shall remain in full force and effect until revoked, suspended, altered or amended by appropriate order of the Commissioner.

Dated: Los Angeles, California.

June 14, 1937.

EDWIN M. DAUGHERTY,
Commissioner of Corporations.

By RONALD H. LOENHOLM,
Deputy.

ASM-LB

[Endorsed]: Filed R. S. Zimmerman Clerk at 35 min. past 1 o'clock Jan. 28, 1938 P. M. By R. B. Clifton, Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

ANSWER TO PETITION AND CONTRAVENTION BY THOMAS K. CASE, A SECURED CREDITOR.

Now comes Thomas K. Case, a secured creditor of the above named corporation and a person interested in and affected by the above entitled proceeding, for his ANSWER and for the purpose of Intervention herein and for the purpose of Controverting the Facts alleged in the Petition of said Corporation, filed herein under Section 77 B of the Bankruptcy Act of the United States, alleges and denies as follows, to-wit:

—I—

alleges that he is the owner and in possession of certain bonds, of the par value of $13,500., issued by said Corporation, as Los Angeles Lumber Products Company First Lien and Collateral Trust Twenty Year, Seven and one-half per cent Sinking Fund Gold Bonds, with the interest coupons attached and that his interest and claim with premium thus represented, amounted on March 1st, 1938, to the total sum of $23,101.87; that the proposed Plan of Reorganization set forth in said Petition of said Corporation, affects materially and adversely the interests of this bondholder who is a secured and non-assenting creditor of Petitioner;

—II—

alleges that the above entitled Court is without jurisdiction to grant the relief prayed for in said Petition; that said Petition does not state facts sufficient to warrant the granting of the relief prayed for therein and that said

Petitioner is not in a legal or equitable position to claim any of the benefits of the Bankruptcy Act of the United States or under the provisions of Section 77 B of said Act;

—III—

alleges that said Petitioner alleges as its only indebtedness the bonded debt represented in part by said bonds referred to in paragraph I of this Answer; that the Plan proposed seeks to subject said bonds and the secured lien thereby created, to cancellation and consequent loss of said lien without due process of law; that said proposed Plan would deprive all bondowners of their liens, while said Corporation would retain and keep as its own, all properties and assets pledged in the Trust Deed securing said bond issue; that said bondowners would thereby be deprived of their right under their said contract to retain said lien until the indebtedness secured thereby has been paid, the right to realize upon said security by a judicial sale, the right to determine when such sale should be held, subject only to the discretion of the Court, the right to protect their interest in the properties by bidding at such sale, the right to have the mortgaged properties devoted primarily to the satisfaction of the debt and the right to control the property meanwhile during the period of default, subject only to the discretion of the Court and to have the rents and profits during such period, applied to the satisfaction of the debt; that all of these are substantive property rights the deprivation of which would be contrary to law and equity; and would, in addition, violate the due process clause of the United States Constitution, Amendment 5 thereof, and would impair the obligation of contracts under the provision of Amendment 14 of said Constitution;

—IV—

alleges that said Plan as proposed in said Petition is neither fair nor feasible; that said Petition shows that said corporation has no creditors it cannot pay and that its only indebtedness is that represented by a small number of owners of a small number of undeposited bonds who have always retained possession thereof and are therefore non-assenting creditors; that the shares of capital stock proposed to be issued under said Plan in lieu of said bonds, would have no market value or other value;

—V—

that this creditor is informed and believes and therefore alleges that the only unpaid, outstanding and undeposited bonds represent a par value of approximately $56,000. and constitute the only indebtedness of said corporation, that more than 97 per cent of the total number of issued bonds now belong to said corporation or to the Trustee named in the Trust Deed securing said bonded debt, to whom the owners of said 97 per cent have sold, assigned and transferred all of their right, title and interest in said bonds and that the remaining portion of less than three per cent is represented by said par value of approximately $56,000. the owners of which have not deposited their bonds with said corporation, or with said Trustee or with any Bondholders' Protective Committee and who have not assented to any past or present proceedings by said corporation or its representatives;

—VI—

that this secured creditor is informed and believes and therefore alleges that said Corporation and/or its Bondholders Protective Committee and the Trustee named in the Trust Indenture securing said bond issue, have pur-

chased and now own approximately $2,509,500. par value of the $2,565,500. the sum alleged in said Petition "as the principal amount of bonds outstanding";

—VII—

Answering paragraph XIII on page 10 of said Petition this creditor alleges that said Corporation alone knows, and has exclusive knowledge of, who and how many of said depositing bondholders have purchased the capital stock of said corporation and accepted the same as the consideration for their bonds and/or to induce them to deposit and to assign and sell their bonds to said corporation and its agents; that said Petitioner withholds from the Court the necessary information to show what bondholders have surrendered their bonds and have assigned their interest therein to said corporation, or to its Trustee, and that said Petitioner exclusively, knows and withholds from the Court the names of the owners and the amount of their bonds, who have not deposited or assigned their bonds and who alone are the owners of the only secured liens upon the properties pledged in said Trust Indenture;

—VIII—

alleges that said owners of said undeposited bonds have the right under their contract represented by said bonds, to retain the lien until the indebtedness secured thereby is paid, have the right to realize upon said security pledged in the Trust Deed by a judicial sale, the right to themselves determine when such sale shall be had, subject only to the discretion of the Court, have the right to protect their interests in the properties by bidding at such sale, have the right to have the mortgaged properties devoted primarily to the satisfaction of the debt and the right to

control the property meanwhile during the period of default, subject only to the discretion of the Court, and to have the rents and profits during such period applied to the satisfaction of the debt represented by said bonds;

—IX—

that this creditor is informed and believes and on such information and belief alleges that the Security-First National Bank of Los Angeles, the Trustee named in said Trust Indenture, acquired by purchase and prior to October, 1935, owned outright between $700,000. and $900,000. of par value of said bonds, that in the year immediately preceding March 20th, 1934, a portion of said bonds representing a par value of $87,500. were purchased and owned by said corporation, that in the year preceding March, 1935, said corporation had purchased and owned a portion of said bonds representing a par value of $129,000. at an average price of 6½ cents for each $1. par value;

—X—

that this creditor is informed and believes and therefore alleges that said corporation has, without right or authority of law, issued and delivered without consideration to many of said former bondowners who were induced to deposit their bonds with it, several thousands of shares of either its Class A and/or Class B capital stock, to induce them to assign their bonds to said corporation or to said Trustee, and to consent to have them cancelled and that said former bondowners are estimated in said Plan to be stockholders entitled to distribution to them of capital to be issued under the proposed plan of reorganization;

—XI—

that this creditor is informed and believes and therefore alleges that said corporation, without right or authority of law, paid many thousands of dollars belonging to said corporation, to one George A. Arms and later, during the year 1936, paid to said Armes the additional sum of approximately $25,000. or more, to secure his agreement to cancel his contract with said corporation and that on the 16th day of January, 1930, said corporation made and entered into a contract with said George A. Armes wherein and whereby it admitted and contemplated certain illegal acts therein specified and pledged and/or assigned to said Armes 64,211 shares of its Class B capital stock;

—XII—

denies that Debtor is "unable to meet its debts as they mature", as alleged by it on lines 9 & 10, page 2 of its Petition herein, and alleges that said Debtor is well able to pay its obligations on its outstanding bonded indebtedness and that the Assets pledged in the Trust Deed, as security for said bonded debt, have a value in excess of its liability thereunder;

—XIII—

alleges that within the last four or five years, said corporation effected, or attempted to effect, a reorganization wherein and whereby it sought to limit its liability to stockholders and creditor and then and thereby adopted as its corporate name "Los Angeles Lumber Products

Company, Ltd." and that this bondowner never consented to said reorganization, is not bound thereby and is and at all times has been a non-assenting creditor of said corporation;

—XIV—

that this creditor is informed and believes and therefore alleges that the sinking fund requirements of said Trust Indenture have not been met for many years and were not promptly complied with prior to the first default of said corporation on February 1st, 1929;

—XV—

Answering paragraph 2 of page 2 of said Petition this creditor denies that said Los Angeles Lumber Products Company, Ltd., is now, or that it has since the year 1925, acted as a holding Company, owning or holding, or that it holds or owns, all or any of the capital stock of the corporations mentioned in said paragraph and alleges that said Los Angeles Lumber Company Ltd. is not legally incorporated as such;

—XVI—

that this creditor is informed and believes and therefore alleges that ever since its incorporation one Daniel Murphy of Los Angeles, has been a large stockholder of said corporation and has ever since acted and does now act as a director of said corporation through his agent and employee, Mr. H. K. Bagley, who was selected by said corporation to act as a director in the place and stead of said Daniel Murphy and as his agent and factor at

all times; that said Daniel Murphy is now and for a great many years last past has been a director of Security-First National Bank of Los Angeles, the Trustee in the Trust Indenture herein involved; that at all times said Daniel Murphy has been and still is a dominant factor in said Bank and in said Debtor corporation; that during the years 1930, 1934 and 1935, said Murphy, and as this creditor is informed and believes and on such information and belief alleges, other officials on said Debtor Corporation, purchased for a reported consideration of $200,000. a release and exemption from their stockholders' liability and that 80,023 or more shares of the original capital stock of said corporation, released said Murphy and other officials from their stockholders' liability; that any such exemptions from stockholders' liability so purchased, was illegal and without authority of law so far as this creditor is concerned and that said stockholders' liability still exists in the event of a deficiency claim which could become due under said Trust Deed and after judicial sale of the assets pledged in said Trust Deed and that said claim is a valuable and substantive right still possessed by this creditor; that said substantive right to a deficiency claim against said Murphy and other officials of said corporation, would be taken away from this creditor, who has never released or assigned the same, by and under the proposed Plan in the above entitled proceeding.

—XVII—

that this creditor purchased all of his bonds prior to the year 1930; that during said year and thereafter

said Debtor Corporation adopted reorganization and other proceedings wherein and whereby it sought to create Supplements and Additions to, and many changes in, the original Trust Deed, known herein as Exhibit E., securing said bond issue; that all of said proceedings and said changes and additions were unilateral, are inequitable and unfair as to this creditor and were made entirely without the consent and without the knowledge of this creditor; that said proceedings and said supplements and additions to said Trust Deed, known herein as Debtor's Exhibits F., G., H. and I, and perhaps other alphabetical letters, were not and are not effective as to this creditor or binding upon him and as to him are illegal and without authority of law or equity and cannot and do not change the contractual relation created by the original bond and original Trust Deed, existing between said Debtor and this creditor.

WHEREFORE Answer is made to said Petition, the above entitled Court is requested to Dismiss said Petition for want of jurisdiction, or to deny the same and render judgment herein enforcing the lien of this bondowner and other bondowners, requiring a judicial sale of and subjecting the assets pledged in said Trust Deed, to the satisfaction of the debt thereby created and grant such other and further relief as to it may seem proper and agreeable to equity.

Dated March 7th, 1938.

Thomas K. Case
Secured Creditor.

State of California,)
County of Los Angeles,) ss:
City of Los Angeles.)

I, Thomas K. Case, the secured creditor mentioned in the foregoing Answer and Contravention, being duly sworn, depose and say that I have read said Answer and know the contents thereof; that the same is true of my own knowledge except as to matters therein stated on information or belief and that as to such matters, and all other statements of facts therein contained, I believe them to be true.

Thomas K. Case

Subscribed and sworn to before me this 7th day of March, 1938.

[Seal] Joseph P. Johnston
Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires August 27, 1941.

[Endorsed]: Received copy of the within Answer this 8th day of March, 1938. Faries & McDowell, Gibson, Dunn & Crutcher, Attorneys for petitioning debtor. Filed. R. S. Zimmerman, Clerk at 33 min. past 12 o'clock, Mar. 8, 1938 P. M. By M. J. Sommer, Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

ADDITION AND AMENDMENT TO ANSWER OF THOMAS K. CASE, DISSENTING, SECURED CREDITOR.

Now comes Thomas K. Case, dissenting and secured creditor herein, as an Addition and Amendment to his ANSWER on file in the above entitled proceeding, appealing to the legal and to the equitable side of the above entitled Court, and to the Chancellor thereof, by way of estoppel and further contravention of the Petition of Debtor above named filed under Section 77 B. of the United States Bankruptcy Act, as paragraph XVIII of his said Answer, the following:

—XVIII—

that this dissenting creditor alleges that the said Debtor herein and the Los Angeles Shipbuilding & Dry Dock Corporation, waived, relinquished and abandoned any possible future right to resort to or file a Petition under the provisions of Section 77 B. of the United States Bankruptcy Act, under and pursuant to the provisions of the Trust Deed executed by said corporations as security for the Bond issue governing the issue of all bonds, and expressly waived, relinquished and abandoned any possible future act or pleading or proceeding by them, as follows, to-wit:

Section 5 of Article 2, page 29 of said Trust Deed: "That they will not apply for nor avail themselves of

any injunction or stay proceedings, or plead or in any way take advantage of any valuation law, apportionment law, appraisement law, stay law, or of any other law, whether now in force or which may hereafter be enacted, which may in any way alter, impair or impede the rights or remedies of the holders of the bonds issued hereunder, "or of the trustee as herein provided, or which shall affect "or change, the time, place, means or mode of perfecting "or enforcing such rights or remedies; and they hereby "expressly waive all benefit and advantage of any and all "such laws. That they expressly waive the equity of "redemption or right of repurchase in case of any fore- "closure sale hereunder, and agree that any and all such "sales may be made free from any and all such rights.";

that said Debtor and said Los Angeles Shipbuilding and Dry Dock Corporation are estopped by law and in equity from any further proceedings in the above entitled matter.

Dated March 16th, 1938.

Thomas K. Case
Secured Creditor.

United States of America,)
Southern District of California,)
County of Los Angeles,) ss:
City of Los Angeles.)

I, Thomas K. Case, the secured creditor mentioned in the foregoing Addition and Amendment to the Answer of Thomas K. Case, being duly sworn, depose and say that I have read said Addition and Amendment and know the contents thereof; that the same is true of my own knowledge and as to all other statements of fact therein contained, I believe them to be true.

Thomas K. Case

Subscribed and sworn to before me this 16th day of March, 1938.

[Seal] R. S. Zimmerman
Clerk U. S. District Court, Southern District of California

By Edmund L. Smith
Deputy

[Endorsed]: Filed R. S. Zimmerman, Clerk at 20 min. past 5 o'clock Mar. 16, 1938 P. M. M. J. Sommer, Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

PROPOSED MODIFICATION
of
PLAN OF REORGANIZATION

NOW COMES the Debtor above named and proposes that the plan of reorganization heretofore submitted to this Honorable Court be modified in the following particulars:

I.

That the provisions of sub-paragraph (1) of the paragraph appearing on page 9 of the plan, under the heading, "Second Method", be amended to read as follows:

(1) In the event the Board of Directors of the corporation deems that the reorganization shall be consummated through a 77B proceeding, or in the event that such a proceeding is otherwise instituted, the depositary, or such other person as the Court may direct, shall file a claim or claims on behalf of all deposited bonds and on behalf of all Class "A" and Class "B" shareholders, and shall consent to the transfer of all the assets of Los Angeles Shipbuilding and Drydock Corporation to the new corporation in exchange for six hundred forty-one thousand three hundred seventy-five (641,375) shares of its five per cent (5%) non-cumulative preferred stock and one hundred eighty-eight thousand six hundred twenty-five (188,625) shares of its common stock. Said shares of stock of the new corporation shall be transferred to

the bondholders and Class "A" shareholders in the following manner:

Six hundred forty-one thousand three hundred seventy-five (641,375) shares of five per cent (5%) non-cumulative preferred stock shall be issued in exchange for outstanding bonds at the rate of two hundred fifty (250) shares of said preferred stock for each one thousand dollars ($1,000.00) principal amount of bonds outstanding. One hundred eighty-eight thousand six hundred twenty-five (188,625) shares of common stock shall be issued to the Class "A" shareholders. The shares of both classes of said stock shall have a par value of one ($1.00) dollar per share.

The articles of incorporation of the new corporation shall provide that the holders of the five per cent (5%) non-cumulative preferred shares shall be entitled, when and as declared by the Board of Directors, to dividends out of any funds of the new corporation legally available for the declaration of dividends at the rate of five per cent (5%) of the par value of such shares, payable in preference and priority to any dividends on the common shares, for the fiscal year in which such dividend is declared, and payable quarterly, or otherwise, as the Board of Directors may from time to time determine. The dividend on the five per cent (5%) non-cumulative preferred shares shall not be cumulative and no rights shall accrue to the holders thereof by reason of the fact that dividends thereon are not declared in prior years.

The holders of common shares of the new corporation shall be entitled to receive in any fiscal year, after said dividend of five per cent (5%) for such year has been paid on the five per cent (5%) non-cumulative preferred shares, when and as declared by the Board of Directors out of any funds of the new corporation available for the declaration of dividends, dividends at the rate of five per cent (5%) on the par value of such common shares for such fiscal year.

After all dividends hereinbefore provided for have been paid upon the five per cent (5%) non-cumulative preferred shares and common shares in any fiscal year, any further dividends paid during any such year shall be paid on all shares of five per cent (5%) non-cumulative preferred stock and common stock equally.

In the event of any liquidation, dissolution, or winding up of the new corporation, whether voluntary or involuntary, there shall be distributed to the holders of five per cent (5%) non-cumulative preferred stock the full par value thereof prior to the distribution of any sums or property whatsoever to the holders of the common shares. After the payment or distribution to the holders of the five per cent (5%) non-cumulative preferred stock of the full par value thereof, there shall be distributed to the holders of common shares all of the remaining assets of the new corporation until there has been paid or distributed to the holders thereof the full par value of the common shares. Any other funds or property of the new corporation available for distribution shall be distributed

ratably to the holders of five per cent (5%) non-cumulative preferred shares and to the holders of common shares.

The Board of Directors of the new corporation, upon its incorporation and organization, shall consist of seven (7) members, being six (6) members of the present Board of Directors of the Debtor and George R. Larwill, one of the attorneys representing certain intervening bondholders in the reorganization proceeding. Such Board of Directors shall hold office until their successors are elected at a meeting of the stockholders of the new corporation, which meeting shall be held within a period of ninety (90) days from and after the date of incorporation of the new corporation, or in the event that such meeting cannot be held within such period, then within such further extension of time as may be provided by order of Court. The new corporation shall take no part in the election of a Board of Directors, except that, prior thereto, it shall send out a formal notice thereof, and a proxy in usual form, but without designation of a proxy holder, together with a letter urging all stockholders to be present in person or to designate someone as their proxy. Any and all persons who desire to be elected a director of the new corporation at such meeting shall solicit votes and proxies entirely at such person's own expense.

The properties of The Masset Timber Company, Limited, and Puget Sound Lumber & Box Company shall be liquidated and the net proceeds derived therefrom shall be distributed ratably among bondholders.

II.

Except as amended as above, said plan of reorganization heretofore filed is not altered or modified.

III.

The foregoing amendment to said plan has been consented to by the Board of Directors of the Debtor, a copy of the resolution evidencing such consent being attached hereto, marked Exhibit "A" and made a part hereof.

Respectfully submitted,

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.

By C. C. Spicer, President.

FARIES & McDOWELL,

By J. Clifford Argue.

GIBSON, DUNN & CRUTCHER,

By J. C. Macfarland.

JCA

[Endorsed]: Filed R. S. Zimmerman, Clerk at 27 min. past 4 o'clock Apr. 8, 1938 P. M. By M. J. Sommer, Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

REPORT OF SPECIAL MASTER

The undersigned, to whom was referred by the Court the above entitled matter for the purposes hereinafter stated, hereby certifies and reports:

These proceedings for corporate reorganization were commenced on January 28, 1938, by the filing of an original petition by the debtor for that purpose, in which petition was included a proposed plan of reorganization. The order approving the petition as properly filed under that Section, and as filed in good faith, was made by the Court the same day, and in such order the Court provided that the debtor corporation should remain in temporary possession of its assets with the powers of a trustee. The minute order making the reference is dated February 28, 1938. On March 2nd the Court signed a formal written order of reference, which was filed March 3, 1938, and which provides that the Special Master shall hold hearings and report to the Court his findings of fact, together with his recommendations, on the following matters:

(1) The assets and business of the Debtor and the conduct, management and control thereof by the Debtor and such other facts as may lead the Court to determine whether or not the order continuing the Debtor in possession of its assets shall be made permanent or whether a Trustee shall be appointed; the salaries and compensation paid to the officers of the Debtor and its subsidiaries, including Los Angeles Shipbuilding and Drydock Corporation, and the relationship of said subsidiaries and their officers to the Debtor.

(2) The good faith, or lack of good faith, of the Debtor in filing the petition herein;

(3) The truth or falsity of the allegations contained in the petition and in any answer, pleading or objection which may be properly filed thereto, including a determination of any issue of fact presented by the said petition, and any such answer, pleading or objection, and the good faith, or lack of good faith, of any person or persons filing any answer, pleading or objection in order that this Court may determine the right of such person or persons to intervene herein;

(4) The total value of the assets of Debtor, including the fair market value of said assets of Debtor subject to the lien of bonds, and the total extent of its liabilities;

(5) The validity of any and all claims filed against the Debtor pursuant to the order of the Court authorizing and requiring the filing of such claims, and the validity of any objections filed by the Debtor or any other person to any such claims;

(6) With respect to the plan of reorganization proposed by the Debtor, the Court further authorized, instructed and empowered the said Special Master to determine and advise the Court as to whether said plan of reorganization

(a) has been filed in good faith;

(b) is fair and equitable;

(c) whether it discriminates unfairly against any creditor or stockholder, or any class or group of creditors or stockholders;

(d) whether the plan is feasible;

(e) whether it complies with Subdivision (b), of Section 77B of the National Bankruptcy Act;

(f) whether it has been accepted as required by Subdivision (c) of Clause 1 of Section 77B of the National Bankruptcy Act;

(g) whether all the provisions of Subdivision (c) of Clause 2 of Section 77B of the National Bankruptcy Act have been complied with.

Hearings were held before the Special Master on March 3, 4, 8, 10, 11, 16, 17, and 18 and April 8, 1938, and the Special Master, in company with officials and employees of the debtor corporation and counsel representing parties in interest, made a personal inspection of the premises of the Los Angeles Shipbuilding and Drydock Corporation, the principal subsidiary of the debtor corporation, at the Los Angeles Harbor on Saturday, March 5, 1938.

The following appearances were made before the Special Master:

Faries & McDowell, by David R. Faries and J. Clifford Argue, and Gibson, Dunn & Crutcher, by J. C. MacFarland, for the Debtor.

George R. Larwill and Frank S. Balthis, Jr. for Thomas A. Ogden, Mae Justice Johnson, Mary O. Rivers, Edwin M. and Maude M. Rankin, C. W. Olson, Helen Avery Cameron, Emma L. Rooks, William Wildburger, Merritt W. Linscott, Anna Edge Linscott, bondholders holding $33,000.00 face value of bonds.

Thomas K. Case, in propria persona, bondholder holding $13,500.00 face value of bonds.

Clarke & Bowker, by Robert M. Clarke, and Earl E. Moss for Adele M. Cowan, bondholder holding $5,000.00 face value of bonds.

William Schoenau, Jr., in propria persona, bondholder holding $12,500.00 face value of bonds.

Overton, Lyman & Plumb, by C. L. McGaughey, for Charlene Coulter and Mary E. Priest, bondholders holding $14,500.00 face value of bonds.

The balance of this report is divided into the following divisions:

I. Summary of the Evidence.

II. Comment on the Original and Modified Plans.

III. Findings and Conclusions.

IV. Motions and Objections.

V. Recommendations.

VI. List of Exhibits.

I. SUMMARY OF THE EVIDENCE

At the hearings before the Special Master ten witnesses testified and twenty-four exhibits were received in evidence. A summary of this evidence is as follows:

The Debtor, the Los Angeles Lumber Products Co., Ltd., is a holding California corporation amenable to bankruptcy proceedings. The following corporations are subsidiaries of the Debtor in that it owns all of the capital stock of each such subsidiary:

1. Los Angeles Shipbuilding and Drydock Corporation, a California corporation.

2. Masset Timber Company, Ltd., a Canadian corporation.

3. Puget Sound Lumber and Box Company, a Washington Corporation.

4. Pacific Wire Bound Box Company, a California corporation.

5. Western Marine Supply Company, a California corporation.

6. Los Angeles Lumber Products Steamship Company, a California corporation.

The financial setup of the Debtor corporation is as follows:

ASSETS:

1. The entire capital stock of each of these subsidiary corporations. This stock has no particular value for the following reasons:

Three of the subsidiaries, viz., Pacific Wire Bound Box Company, Western Marine Supply Company, and Los Angeles Lumber Products Steamship Company, have no assets. The Masset Timber Company, Ltd., has some assets but these are of doubtful value. The Puget Sound Lumber and Box Company has some amount of assets, but their realizable value is uncertain and a matter of the future. The assets of both the Masset Timber Company, Ltd. and of the Puget Sound Lumber and Box Company are pledged as part of the security under the bond trust indenture hereinafter mentioned.

Masset Timber Company, Ltd., owns twenty-four (24) licenses issued by the Government of British Columbia, Canada, comprising approximately 12,000 acres of timber lands on Graham's Island in said British Columbia. This corporation owns real estate there upon which are located certain buildings, wharves, and docks. It is non-operating and represents an annual expense of $9,000.00

to Debtor in carrying charges. An appraisal of said property is attached as "Exhibit A" to debtor's original petition filed herein for corporate reorganization. Such property has no real value. This corporation has no outstanding indebtedness.

Puget Sound Lumber and Box Company owns certain real estate, buildings, wharves, and docks, comprising a sawmill and box factory, located on Lake Union in Seattle, Washington. This property has a water frontage of approximately 700 feet on said Lake. The plant has been non-operative since 1925 and has since said time been almost completely dismantled, the sawmill building being all that remains. The residential district of Seattle has extended to within a short distance of the property, and it has been zoned so that a resumption of former operations is impossible. While the buildings were originally erected at a great cost, they are specially constructed and unfit for other purposes. The water adjacent to the docks is of insufficient depth to permit commercial vessels of average draft to moor thereto for the discharging of cargo. The docks and wharves are in need of extensive repairs necessitating the expenditure of sums in excess of their worth. An appraisal of said property is attached as "Exhibit B" to Debtor's original petition filed for corporate reorganization. The property has value only as real estate of between $25,000.00 and $40,000.00. The annual expense to debtor of carrying said property is $3,500.00. Said corporation has no outstanding indebtedness.

The estimated annual expense of maintaining the debtor corporation and these shutdown properties, if a reorganization is not effected, is $21,500.00.

The Los Angeles Shipbuilding and Drydock Corporation has substantial assets, but its fixed assets are subject to the lien of a Trust Indenture dated March 8, 1924, (Debtor's Exhibit E, as modified by supplemental indentures, Debtor's Exhibits F, G, and H) securing the payment of bonds upon which there is now due a great deal more than the value of such assets. The original trustees under this Trust Indenture were Pacific-Southwest Trust & Savings Bank and Wm. Rhodes Hervey, but the present trustees are Security-First National Bank of Los Angeles, as successor in interest of Pacific-Southwest Trust & Savings Bank, and W. N. Bucklin, Jr., as successor in interest to Wm. Rhodes Hervey. This Los Angeles Shipbuilding and Drydock Corporation has only current debts of small amount besides its obligation on the bonds. It has current assets not subject to the lien of the bond indenture, which have a value of several hundred thousand dollars, but these would ultimately all be eaten up by the bondholders after the payment of these current debts, since there is pledged under the Trust Indenture, as partial security, all of the capital stock of the Los Angeles Shipbuilding and Drydock Corporation.

2. Cash in bank, $1178.27.

3. Accounts receivable, collectible, $5,199.50.

4. Sinking fund account, $3,070.48.

5. Leasehold interest in 68.54 acres of water frontage at the Los Angeles Harbor under lease from the Harbor Department of the City of Los Angeles, a municipal corporation. This is carried on the books of the debtor at no value and probably has no realizable value for creditors in the event of a liquidation.

LIABILITIES:

1. Principal and interest amounting to some $3,807,071.88 upon first lien bonds issued March 8, 1924, secured by said Trust Indenture, which covers the capital stock and all of the assets of the subsidiaries. No interest has been paid on the bonds since Feb. 1, 1929.

2. Accounts payable, current, $6,075.94.

3. Account due the said Los Angeles Shipbuilding and Drydock Corporation, $496,890.76.

The Debtor is insolvent both in the equity sense, i. e., it is unable to pay its debts in the ordinary course of business as they mature, and in the bankruptcy sense, i. e., its assets at a fair valuation are insufficient to pay its debts.

The Debtor's plant is located at Los Angeles Harbor, San Pedro, California, and its business consists of the construction and repair of ships through its principal subsidiary, the Los Angeles Shipbuilding and Drydock Corporation. The Debtor formerly engaged in the lumber business, through its other subsidiaries, but that line of business has long since been abandoned as unprofitable. The history of the Debtor goes back to the World War when it was very active in ship construction and at one time had over 12,000 men in its employ. The Debtor, through its subsidiaries, has handled over $100,000,000.00 of work.

The plant of its chief subsidiary, Los Angeles Shipbuilding and Drydock Corporation, is located upon some sixty (60) acres of water frontage under lease to the Debtor from the Harbor Department of the City of Los Angeles. This lease runs until 1952, carries an annual rental of $21,500.00, which is subject to adjustment in

1942 for the balance of the term, and provides that upon its termination the buildings and other permanent fixtures shall revert to the City. The premises are subleased by the Debtor holding company to its said chief subsidiary, which carries on the active operations. The plant has four building ways, a wooden drydock with a capacity of 12,000 tons, a plate shop, a machine ship, a blacksmith shop, a pipe shop, a joiner shop, a paint department, a welding department, an executive office building, etc. Most of these are in good condition. Just now and for some time past the company has been engaged in repair work principally for the Standard Oil Co., the Union Oil Co., the General Petroleum Corp., the Richfield Oil Co., and the American-Hawaiian Steamship Co. If a shipbuilding construction program is undertaken, it will require about $500,000.00 to place the four building ways in first class condition, or, if all four are not rehabilitated at one time, about $150,000.00 for the first one and lessening graduated amounts for the other three, but not to exceed $500,000.00 in all. Only a small amount of money will be required to put the rest of the plant in first class order. If an extensive shipbuilding program were undertaken, it would be advantageous to move the drydock nearer the center of the plant, and if this were done, about forty per cent of the leasehold could be surrendered and a saving made in the lease rate.

The principal officers of the shipbuilding company are C. C. Spicer, President, whose salary is $1,000.00 per month, J. B. Ingoldsby, Secretary, whose salary is $400.00 per month, and George Sutherland, Superintendent, whose salary is $600.00 per month. All are experienced and capable men. Spicer has been prominent in the business life of the Los Angeles area for many

years, is President of the Republic Petroleum Co., and is a substantial bondholder of the Debtor. His acquaintanceship and influence among the officials of the large business and financial corporations of Southern California is extensive. After he reorganized the business of the shipbuilding company in 1936, he effected a saving in operating costs of between $40,000.00 and $50,000.00 per year. Ingoldsby is an efficient Secretary, and is doing the same work for which the former secretary and an assistant-secretary were paid a total of $1,000.00 per month. The Superintendent has spent his lifetime in the shipbuilding business. He served his apprenticeship upon the Clyde in Scotland and has worked for a number of shipbuilding concerns in this country and has been with the Los Angeles Shipbuilding and Drydock Corporation since 1923 and its Superintendent for about two years.

The United States Government is planning the construction for the Navy of many warships and auxiliary vessels, the latter including mine sweepers, oil tankers, coast guard cutters, etc. The plant of the Los Angeles Shipbuilding and Drydock Corporation is not large enough to construct naval vessels but it could build the auxiliary vessels. Much of our present merchant marine is obsolete and must be replaced in a few years. Shipyards on the Atlantic Coast are occupied now with new construction, and soon the Pacific Coast yards will be called upon for this work. In San Francisco there is the Bethlehem Shipyard; in Oakland the Moore Drydock Company and the General Engineering & Drydock Company; and in Los Angeles a branch of the Bethlehem Shipyard and a small yard called the Craig Shipyards. There are no shipyards of any appreciable size in Seattle, Tacoma, or Portland. One ship could be constructed at a time on each of the

building ways and completed in a period of about two and a half years. The gross cost of the four ships would be about $9,200,000.00 with a ten per cent profit of about $920,000.00. In the meantime the present maintenance and repair work could be carried on as usual, especially since there would be plenty of skilled men on hand. There are two more building ways which were used during the World War and which could be rehabilitated during an emergency so that more than four ships could be constructed at one time. A program of constructing four ships at one time would require about 2500 to 3000 additional men, skilled and unskilled. It would not be difficult to recruit skilled men from the local area and from other parts of the United States. From 1917 to 1921 there were 35 ships built at this yard by the United States Shipping Board, and since that time 22 additional vessels have been built, including the steel passenger ship "Catalina" now plying between Wilmington and Catalina Island. The present repair work consists of drydocking and making annual repairs, and insurance jobs which are the result of collisions, groundings, etc. At present the largest part of the business of the yard is the repair of oil tankers. The labor situation is improving at Los Angeles Harbor, and it is anticipated there will not be a great deal of difficulty along this line if a program of new construction is commenced. The removal of the drydock from its present location to nearer the center of the plant would tend towards greater efficiency, but it is not essential. The cost would be about $100,000.00. This removal, however, would prevent using more than four building ways.

The United States Maritime Commission recently investigated the Los Angeles Harbor as a site for new con-

struction work in connection with a revival of the American merchant marine. The Commission contemplates a ten-year program with 500 new ships in view at a cost of $1,250,000.00. For immediate purposes the plan is to build three different types of smaller ships with varying speed, and such construction would fill all the shipyards in the United States, and such type of ships could be constructed here. A naval and shipbuilding expert recently surveyed the local yard for the Commission and reported very favorably upon its condition and prospects. There are pending in Congress bills to allot to the Pacific Coast forty per cent of all such construction with a six per cent differential in cost.

From 1930 to 1936, during the Armes regime, hereinafter referred to, the working capital of the Los Angeles Shipbuilding and Drydock Corporation decreased from $525,000.00 to $394,905.99, or a loss of $130,094.01. Thereafter, with the end of the Armes era and during the substitued Spicer regime, hereinafter mentioned, this working capital as of December 31, 1937, showed a rise to $434,636.85, or an increase of $39,730.86. At the end of the year 1937 the profit and loss account permitted the addition of $62,835.21 net income to surplus after allowance for depreciation and taxes. The Debtor corporation, during the past few years, has financed itself by loans from the Los Angeles Shipbuilding and Drydock Corporation, its principal and only profitable subsidiary.

Sec. 11 of Art. IX, page 79, of the Trust Indenture provides that any provision may be altered, or abrogated, or additional provisions adopted, by a supplemental indenture executed and recorded by the Debtor corporation and by its principal subsidiary, the Los Angeles Ship-

building and Drydock Corporation, and by the trustee under the Indenture, if the same shall be consented to by the owners or holders of seventy-five per cent of the principal of the bonds, or by the underwriters who sold the bonds and the owners or holders of a majority in amount of such principal, and no alteration is made which creates any discrimination among the bonds themselves. Sec. 5 of Art. II, page 29, of the Trust Indenture, provides that the said parent corporation and its subsidiary will not seek any injunction, or plead or take advantage of any valuation law, apportionment law, appraisement law, stay law, or any other law, whether then in force or thereafter enacted, which may in any way alter, impair, or impede the rights or remedies of bondholders or the trustee under the Trust Indenture, or which shall affect or change the time, place, means, or mode of enforcing such rights or remedies, and that they expressly waive the benefits of all such laws. The bonds themselves contain a specific reference to the Trust Indenture as defining the rights and remedies of the bondholders.

In 1930 a reorganization of the Debtor corporation was effected through the medium of a Bondholders' Protective Committee, with the consent of bondholders owning over ninety-seven per cent of the face value of all bonds outstanding, and pursuant to such provisions of Sec. 11 of Art. IX of the Trust Indenture. The principal features of this reorganization were as follows: The old stock of the corporation was wiped out by assessment. New stock was issued, divided into Class A and Class B, with equal voting rights. Class A stock was issued to some of the old stockholders who contributed $400,000.00 new money, which was turned over to the Los Angeles Shipbuilding and Drydock Corporation and by it used as working

capital. In consideration of this contribution, the bondholders released stockholder's liability as to such contributors. Class A stock was to have a $400,000.00 plus interest preference over Class B stock upon liquidation. Class B stock in a small amount was issued to such of the bondholders who accepted the same, in payment of unpaid bond interest coupons. A large block of Class B stock, a majority of all stock with controlling voting rights, was issued in the name of George D. Armes and placed in escrow to be delivered to Armes when all the bonds were retired and the Class A shareholders were paid back their $400,000.00 contributions plus interest in the form of dividends, distributions, or by way of liquidation. Armes was given a ten year contract as President and General-Manager at a salary of $2,000.00 per month plus expenses. Interest on the bonds was reduced from 7½% to 6%, payable only out of net earnings. No dividends were to be paid upon the new stock until all the bonds were retired. The bonds themselves will not mature until 1944, and the result of this arrangement is that, for all practical purposes and unless the debtor corporation is reorganized, the bonds will not be in default until that year, and in the meantime there cannot be any foreclosure because there will not be any default in payment of interest. The bonds of those consenting to this arrangement were deposited with the Security-First National Bank of Los Angeles as a special trustee, and trust certificates were issued in lieu thereof to such depositing bondholders.

Thereupon Armes took over active management and control of the company and placed upon the board of seven directors four of his own men. This arrangement continued for some six years but did not work out well, and in 1936 the Armes contract was terminated

upon the payment to him of $28,000.00 out of a possible total liability under the contract of $96,000.00, and his four directors supplanted by new men, two of whom were sponsored by the bondholders and two by the Class A stockholders. The Armes Class B stock in escrow was cancelled and thus the Class A stockholders who had contributed the $400,000.00 came into control of the company.

Under the Armes contract, George A. Armes was given the beneficial interest in, and the right to vote, 64,211 Class A shares of stock, and this represented the majority control of all stock, Class A and Class B. It was further provided that this stock should be held in escrow by the Title Insurance and Trust Company, a corporation, as trustee, and that such trustee should deliver these shares of stock to the said Armes, as beneficiary and owner thereof, when he fully completed his contract, but if, for various specified reasons, not including, however, the cancellation of the contract by mutual agreement, the contract was terminated, this stock should be delivered by the trustee under the deposit agreement to Peirce, Fair & Co., one of the four underwriters who originally sold the bonds. When the Armes contract was cancelled by mutual agreement in 1936, Peirce, Fair & Co. had gone out of business and ceased to exist and had not been succeeded by any other firm, person, or corporation. Under these circumstances and without any attempt to resort to the provisions of Section 2287 of the Civil Code of California, the said Armes stock was delivered up by the said Title Insurance and Trust Company, as such trustee, to the debtor corporation and cancelled. The Armes contract was not cancelled and terminated as a part of any plan to take away any control or management from the

bondholders and to give the same back to any stockholders, nor did the Armes contract give the control and management of the debtor corporation to the bondholders. While such cancellation of the stock appears to be in technical violation of the provisions of the 1930 reorganization, still the same was not prejudicial or adverse to the rights of the bondholders or any of them, because the Armes contract arrangement, while it was at the instance of bondholders, was made with the purpose in view of giving Armes himself eventually control of the operation of the business of the debtor corporation through stock ownership on account of his supposed ability and experience, and it was never intended by the parties that the Armes contract was to be entered into for the purpose of giving the bondholders themselves control of the debtor corporation, or with the end in view that if such Armes contract were terminated by cancellation, this Armes stock should revert to the bondholders directly or indirectly for their use and control. Prior to the cancellation of the said Armes stock, as aforesaid, said Armes had the control and management of the corporation by the following representation on the Board of Directors: Messrs. Armes, McHose, Thatcher, and Crowley, and the interests of the other stockholders were represented on such Board by Messrs. Spicer, Baker and Bagley. Upon the cancellation and termination of the Armes agreement and the cancellation of the Armes stock, the said Armes, McHose, Thatcher, and Crowley resigned from the Board, and thereupon four additional members were duly and regularly elected, such additional members being: W. I. Hollingsworth and W. W. Powell, sponsored by stockholders, and David R. Faries and Harry W. Watson,

sponsored by bondholders. After such appointment, the Board of seven directors consisted of five sponsored by stockholders and two sponsored by bondholders, and such Board has ever since dominated and controlled the said corporation.

A new reorganization was attempted in 1937, which was determined by the California State Corporation Commissioner, after proper hearings upon notice, to be fair and equitable. This plan contemplated: The formation of a new corporation, which was to be known as the Los Angeles Shipbuilding and Drydock Corporation, and which would acquire all of the assets of the Debtor corporation, free and clear of liens, except the stock of the Masset Timber Company, Ltd. and the Puget Sound Lumber and Box Company. The new corporation was to have an authorized capital of $1,000,000.00 divided into 1,000,000 shares of the par value of $1.00 per share, with 830,000 of these shares to be issued to the bondholders on the basis of 230 shares to each $1,000.00 bond, or 590,065 shares, and 239,935 shares to the holders of Class A stock. The balance of 170,000 shares was to be sold for cash to raise working capital. There were 5112 shares of Class B stock which had been issued to bondholders in payment of defaulted interest. When the Armes contract was terminated as above related, these 5112 shares were all that were left in Class B; and the proposal was to eliminate these also. The parent company and all of the subsidiaries were to be liquidated and dissolved. Any salvage from the Masset Timber Company, Ltd. and the Puget Sound Lumber and Box Company was to be used for the benefit of the old bondholders on a pro rata basis.

Because of the top heavy bond structure, the Debtor and its principal subsidiary, Los Angeles Shipbuilding and Drydock Corporation, were unable to expand the business through inability to secure faithful bid and performance bond in the construction of new ships. The bonds were sold on the market for as low as $60.00 per $1,000.00. The Los Angeles Shipbuilding and Drydock Corporation's fixed assets, appraised at $465,000.00 by the American Appraisal Co. were directly subject to the bond issue. Its other assets, representing working capital, including cash, accounts receivable, materials and supplies, etc., in 1937 were estimated at $365,203.23. These were not directly subject to the bond issue but could be ultimately reached from that source for the benefit of bondholders by the trustee under the Bond Indenture, because of the pledge under the Bond Indenture of all of the capital stock of this subsidiary corporation.

It was proposed that this 1937 plan be consummated by one of two methods, either (1) by consent of the parties, or (2) a Bankruptcy Act Section 77B proceeding; and that the method to be followed would be determined by the Board of Directors of the Debtor corporation. The second method was finally adopted by the Board, owing to its inability to obtain sufficient consents without court action to the first method.

When the Debtor corporation filed its petition for reorganization under Section 77B herein, it included therein the plan so proposed in 1937. This contemplated, in addition to the features already detailed, that the Board of Directors of the new corporation would be the same as that of the old corporation until the new stockholders elected their successors. The present Board of Direc-

tors consists of C. C. Spicer, President, David R. Faries, W. W. Powell, Milo A. Baker, H. K. Bagley, W. I. Hollingsworth, Jr., and Harry W. Watson. J. G. Ingolsby is Secretary, and J. C. Argue, Assistant-Secretary. The proportion of present bondholders to the present Class A stockholders, as new stockholders, would be approximately 71% to 29%. The new stock is to be non-assessable. All creditors of the Debtor, other than the bondholders and its subsidiaries, and all expenses of administration, are to be paid in cash. The Security-First National Bank of Los Angeles is to be the depositary and medium for the transmission of bonds into new stock.

In the solicitation of acceptances to the proposed plan, the Debtor went directly to the bondholders and old stockholders and not through the medium of any committees or trustees or depositaries.

If the Judge decides to appoint a permanent trustee of the Debtor, C. C. Spicer is willing to act under appropriate bond for the faithful performance of his duties without any compensation in addition to his salary as President of the Los Angeles Shipbuilding and Drydock Corporation; or, if the Judge continues the Debtor in permanent possession, Spicer is willing to continue as President of the Los Angeles Shipbuilding and Drydock Corporation at the same salary and furnish a bond for the faithful performance of his duties in such amount as the Court may fix. The premium on any such bond, if furnished by a surety company, would be at the rate of $1.00 per $100.00 per year.

During the hearings before the Special Master, the Security-First National Bank of Los Angeles, as agent of the Debtor, filed a certificate showing that as of March

19, 1938, there has been deposited with it acceptances of this proposed plan on the part of the holders of $2,282,-500.00 of bonds out of a total of $2,565,500.00 outstanding, or 88.9÷%; and 56,921.18 of Class A shares out of a total of 57,065.65 outstanding, or 99÷%; and 4558 of Class B shares out of a total of 5112, or 89÷%. The Debtor has had difficulty in communicating with all bondholders on account of absence, death, incapacity, change of address, etc.; and some have been loath to act on account of pending court proceedings and the necessity of going to the expense of obtaining court approval.

The present stockholders, holding Class A shares, comprise some of those who were stockholders prior to the 1930 reorganization, or their successors in interest. The financial investment from the beginning of these stockholders, or their predecessors in interest, and the bondholders, has been approximately equal, in the sum of $2,500,000.00 for each class. At the time of the 1930 reorganization, the assets then remaining were worth approximately $400,000.00. If the bonds had been then foreclosed without such reorganization, this sum is about the maximum that the bondholders would have received. As a part of that reorganization plan, the stockholders paid in $400,000.00 in cash to permit the corporation to continue its business. A list of bondholders and stockholders was filed herein March 3, 1938, under the title of "Security Holders of Record as of February 2, 1938". This list discloses a great many bondholders with bonds in comparatively small amounts and the bond-

holders themselves widely scattered. A few of the Class A stockholders are also bondholders. A list of the bondholders, holding $10,000.00 or more, is as follows:

Assets Corporation, 825 Pacific Southwest Bldg., 215 W. 6th St., Los Angeles	$79,500.00
H. K. Bagley, 831 Standard Oil Bldg., 605 W. Olympic Blvd., Los Angeles	20,000.00
Spencer Brush, 111 Sutter St., San Francisco,	26,500.00
Helen Avery Cameron, 2101 West Adams Blvd., Los Angeles,	10,000.00
Thomas K. Case, 1757 N. Kingsley Ave., Los Angeles,	13,500.00
Edith W. Davis, 1749 N. Serrano Ave., Hollywood,	10,000.00
District Bond Company, 433 So Spring St., Los Angeles,	23,500.00
Barbara Edwards, 1275 Subway Terminal Bldg., 417 So. Hill St., Los Angeles	$52,500.00
T. J. Garwood, 310 *W.* Broadway, Los Angeles	12,000.00
Sam Green, 639 So. Spring St., Los Angeles	19,500.00
Charles W. Griffin, J*d.*, 144 Woodland Way, Piedmont,	10,000.00
Richard E. Hartter, 820 Steiner Street, San Francisco	10,000.00
Hellmann-Wade and Company, 517 California St., San Francisco,	10,000.00

Vernon G. Matthews, Cuyamiaca Club, San Diego,	12,500.00
F. McMichael, c/o C. C. Spicer, 1006 Signal Bldg., 811 W. 7th St., Los Angeles,	53,000.00
George L. Machris, 2455 E. 27th St., Los Angeles	86,000.00
W. S. Martin, 1175 Beverly Way, Altadena	11,500.00
Newton H. Neustadter, 755 Market St., San Francisco	10,000.00
Mary E. Priest, Room 1007, 811 W. 7th St. Bldg., Los Angeles,	11,500.00
Charles H. Robbins, 2870 St. James Place, Altadena,	20,000.00
Samuel F. Schultz, 1114 Center, Hannibal, Mo.	10,000.00
Security Company (an affiliate of the Security-First National Bank of Los Angeles) 215 W. 6th St., Los Angeles,	676,500.00
Godfred Theusen, Route 1, Box 228, Mountain View, California,	10,000.00
Mrs. Edna Wilson, 2400 Ridge Rd., Berkeley,	10,000.00
Total	$1,208,000.00

Out of a total of about 757 bondholders, 24 represent $1,208,000.00 in bonds, and the balance of about 733 represent scattered holdings of less than $10,000.00 each, ranging all the way from $500.00 up to $10,000.00, and totaling $1,364,700.00. Some of the Class A share-

holders are persons who have been, in the past, and who are now active in the business operations of the Debtor and its subsidiaries, and familiar with ship construction and repair, and who are influential in the business and financial life of the Los Angeles area. Among them are Bank of America, J. H. Braly, Estate of W. I. Hollingsworth, J. A. Jevne, Daniel Murphy, C. C. Spicer, and George W. Walker. Their good-will and assistance, in the event of a reorganization which recognizes the present Class A stockholders, may be of considerable help to the reorganized company in its future business operations. No evidence was presented showing that the bondholders, or any of them, except such of them as are holders of Class A stock, have been, or are now active in the business operations of the Debtor and its subsidiaries and familiar with ship repair and construction.

II. COMMENT ON THE ORIGINAL AND MODIFIED PLANS OF REORGANIZATION

During the course of the hearings before the Special Master, and in view of the insolvency of the Debtor corporation, both in the equity and in the bankruptcy sense, which not only appeared from the evidence but was also conceded by all of the parties appearing, discussions were had among counsel and with the Special Master relative to the advisability of allowing the old Class A stockholders to share in the stock of the reorganized company, either at all or to a limited extent. The decisions of the Federal Bankruptcy Courts in these reorganization matters upon this question indicate that where insolvency exists creditors must be fully compensated before the old stockholders can be admitted into the picture, unless such

old stockholders furnish new consideration by way of cash contributions, or by way of continuity of management where such may be important under existing circumstances to the life of the reorganized corporation, or because of some other reason which equity should recognize.

The proposed plan set up in the Debtor's original petition filed herein for reorganization does not provide for the furnishing of any new money by the old Class A shareholders. It was contended before the Special Master by those opposing this proposed plan that the only sufficient consideration for letting the old stockholders in would be the furnishing by them of new money in an adequate amount. The proponents of the plan, on the other hand, contended that the following were adequate equitable reasons why the old Class A stockholders should be given an interest in the reorganized corporation:

1. The financial investment of the said stockholders in the Debtor corporation is approximately equal to that of the present bondholders in that the bondholders' original investment was approximately $2,500,000.00, and the present Class A shareholders likewise invested approximately the same amount in the company throughout its existence.

2. At the time of the 1930 reorganization, the assets then remaining were worth only a little over $400,000.00, and had the bonds been then foreclosed, all that the bondholders would have received would have been approximately this amount, which was equivalent to the $400,000.00 in cash paid into the Debtor corporation at that time by these old stockholders.

3. The Class A stockholders group are the only people connected with the company who are familiar with its past history or who have had any experience in connection with shipbuilding, and their accumulated experience is of value to the company and should be preserved, and they have among their number individuals who not only have been active in the past management of the company but who have business contacts which are of material value to the company, such as contacts with financial institutions, and with oil companies, who now constitute the Debtor's principal customers.

4. Most of the bondholders are widely scattered with small holdings and with little financial experience or strength, and their position in the new company would be materially bettered by having associated with them men of financial experience, ability, and strength, such as these old Class A stockholders, in that such men would give the reorganized company a financial stability in the future which it would not otherwise have.

5. In the 1930 reorganization setup, the furnishing of the $400,000.00 in cash by these old Class A stockholders was upon the basis that there would not be a foreclosure of the bonds until 1944, now six years hence, and if the proposed plan in these proceedings is not confirmed, the bondholders will be required to wait until 1944 before they can either sell out the assets and appropriate the proceeds or take over the assets themselves, through the medium of foreclosure proceedings, and in the meantime the opportunity to reorganize the company and participate in any program of shipbuilding sponsored by the United States Government will be lost, with the present stockholders continuing on in the management and control of the company.

6. If the bondholders attempted, through the medium of these proceedings, to eliminate the old stockholders entirely, such stockholders would have the right to engage in litigation to recover from the bondholders their $400,000,00, put up in 1930, upon the theory that reorganization herein which does not recognize such old Class A stockholders will be tantamount to a foreclosure of the bonds and the deprivation of the stockholders, without due process of law, of their right to continue on with the management and operation of the company, at least until 1944, by reason of the estoppel created by the 1930 reorganization.

7. If the proposed plan does not go through, and there is a foreclosure, the expenses thereof would be heavy, probably much larger than the reorganization expenses herein; and the probabilities are that the assets would be eaten up to a large degree in the meantime if the foreclosure is not held until 1944, or in litigation if the foreclosure is advanced to a sooner date by court proceedings.

The plan proposed in the Debtor's original petition contemplates a new stock division with one class of shares to be on the basis of 71% to the bondholders and 29% to the old Class A stockholders. As a result of *these* discussions, a modified plan has been formulated and presented by the Debtor corporation, which contemplates the letting in of the old stockholders but upon a different setup, wherein the bondholders are given a 77% interest as against a 23% interest in the old stockholders, and are given preferences over the old stockholders in the way of dividends and upon liquidation. The modified plan refers to preferred and common stock to be issued to bondholders and old stockholders respectively, and we will refer to

the same, in our discussion, as new Class A and new Class B respectively.

A representative of the bondholders is to be immediately appointed a director of the new corporation, which will have seven directors, and take his seat upon the Board of Directors thereof, along with six of the members of the present Board of Directors of the Debtor corporation. An election of new directors for the new corporation under the reorganized setup is to be held within ninety days, under the supervision of the Court, and the Debtor corporation and its officers and directors are to remain neutral in such election.

This modified plan, inasmuch as it does not materially and adversely affect the bondholders over the plan originally proposed, would probably not have to be submitted to them for ratification or rejection. With respect to the old stockholders, inasmuch as insolvency exists, it is possible that the submission of the modified plan to them for acceptance or rejection may not be necessary, but the Debtor corporation, out of abundant caution, proposes to submit this modified plan to the old stockholders for that purpose.

This modified plan, in substance, is as follows:

The provisions of sub-paragraph (1) of the paragraph appearing on page 9 of the plan, under the heading, "Second Method", are to be amended to read as follows:

(1) In the event the Board of Directors of the corporation deems that the reorganization shall be consummated through a 77B proceeding, or in the event that such a proceeding is otherwise instituted, the depositary, or such other person as the Court may direct, shall file a

claim or claims on behalf of all deposited bonds and on behalf of all Class "A" and Class "B" shareholders, and shall consent to the transfer of all the assets of Los Angeles Shipbuilding and Drydock Corporation to the new corporation in exchange for six hundred forty-one thousand three hundred seventy-five (641,375) shares of its five per cent (5%) non-cumulative preferred stock and one hundred eighty-eight thousand six hundred twenty-five (188,625) shares of its common stock. Said shares of stock of the new corporation shall be transferred to the bondholders and Class "A" shareholders in the following manner:

Six hundred forty-one thousand three hundred seventy-five (641,375) shares of five per cent (5%) non-cumulative preferred stock shall be issued in exchange for outstanding bonds at the rate of two hundred fifty (250) shares of said preferred stock for each one thousand dollars ($1,000.00) principal amount of bonds outstanding. One hundred eighty-eight thousand six hundred twenty-five (188,625) shares of common stock shall be issued to the Class "A" shareholders. The shares of both classes of said stock shall have a par value of $1.00 per share.

The articles of incorporation of the new corporation shall provide that the holders of the five per cent (5%) non-cumulative preferred shares shall be entitled, when and as declared by the Board of Directors, to dividends out of any funds of the new corporation legally available for the declaration of dividends at the rate of five per cent (5%) of the par value of such shares, payable in preference and priority to any dividends on the common shares, for the fiscal year in which such dividend is declared, and payable quarterly, or otherwise, as the Board of Directors

may from time to time determine. The dividend on the five per cent (5%) non-cumulative preferred shares shall not be cumulative and no rights shall accrue to the holders thereof by reason of the fact that dividends thereon are not declared in prior years.

The holders of common shares of the new corporation shall be entitled to receive in any fiscal year, after said dividend of five per cent (5%) for such year has been paid on the five per cent (5%) non-cumulative preferred shares, when and as declared by the Board of Directors out of any funds of the new corporation available for the declaration of dividends, dividends at the rate of five per cent (5%) on the par value of such common shares for such fiscal year.

After all dividends hereinbefore provided for have been paid upon the five per cent (5%) non-cumulative preferred shares and common shares in any fiscal year, any further dividends paid during any such year shall be paid on all shares of five per cent (5%) non-cumulative preferred stock and common stock equally.

In the event of any liquidation, dissolution, or winding up of the new corporation, whether voluntary or involuntary, there shall be distributed to the holders of five per cent (5%) non-cumulative preferred stock the full par value thereof prior to the distribution of any sums or property whatsoever to the holders of the common shares. After the payment or distribution to the holders of the five per cent (5%) non-cumulative preferred stock of the full par value thereof, there shall be distributed to the holders of common shares all of the remaining assets of the new corporation until there has been paid or distributed to the holders thereof the full par value of the

common shares. Any other funds or property of the new corporation available for distribution shall be distributed ratably to the holders of five per cent (5%) non-cumulative preferred shares and to the holders of common shares.

The board of Directors of the new corporation, upon its incorporation and organization, shall consist of seven members, being six members of the present Board of Directors of the Debtor and George R. Larwill, one of the attorneys representing certain intervening bondholders in the reorganization proceeding. Such Board of Directors shall hold office until their successors are elected at a meeting of the stockholders of the new corporation, which meeting shall be held within a period of ninety (90) days from and after the date of incorporation of the new corporation, or in the event that such meeting cannot be held within such period, then within such further extension of time as may be provided by order of Court. The new corporation shall take no part in the election of a Board of Directors, except that, prior thereto, it shall send out a formal notice thereof, and a proxy in usual form, but without designation of a proxy holder, together with a letter urging all stockholders to be present in person or to designate someone as their proxy. Any and all persons who desire to be elected a director of the new corporation at such meeting shall solicit votes and proxies entirely at such person's own expense.

The properties of the Masset Timber Company, Limited, and Puget Sound Lumber & Box Company shall be liquidated and the net proceeds derived therefrom shall be distributed ratably among bondholders.

It is possible that, at first glance, some might think that there is a question as to whether or no the old stock-

holders should be given any consideration in the reorganization to be effected in this proceeding. However, the bondholders are given voting control and preferential rights in respect to both dividends and liquidation, and will probably receive as much in the end as if there were a liquidation now through foreclosure outside of this proceeding or in this proceeding under subdivision (k) of Section 77B. Subdivision c-(8) of that Section provides that if a plan of reorganization is not proposed or accepted within the period fixed by the judge, or, if proposed, is not confirmed, the judge may, after hearing, either (1) dismiss the proceeding or (2) direct the estate to be liquidated, as the interests of the creditors and stockholders may require. When a liquidation order is made the liquidation proceeds under subdivision (k) in the same manner as in an ordinary bankruptcy. In the case here, if there were a liquidation order, there would be a serious question whether the Court could liquidate the assets secured by the bond Indenture without the consent of all of the bondholders. In ordinary bankruptcy, it is generally held by the courts that property covered by liens in which there is no equity for general creditors, as here, will not be liquidated by the Bankruptcy Court unless the lienholders consent, or, at least, do not object. The reason is that no benefit will be derived by the general creditors from such liquidation and the lienholders may prefer to liquidate their liens in some other forum. Some of the old Class A stockholders of the Debtor are bondholders, and it is quite likely that, if an order of liquidation were made herein under 77B-c-(8), they would oppose the foreclosure of the bond Indenture under 77B-(k). If, on the other hand, the proceedings are dismissed, the bondholders will be faced with the proposition that they cannot foreclose until 1944 and cannot operate the

company in the meantime. Its assets, through lack of adequate working capital, and the business itself, through inability to secure proper refinancing owing to the bond structure, may easily diminish to such a point that the entire enterprise will finally die through dry rot. If contracts are secured for the construction of new ships, it will be necessary to furnish faithful performance bonds, and in view of existing conditions any surety company would undoubtedly hesitate to supply the same unless adequate collateral is furnished to indemnify it against loss. This is something the Debtor corporation and its subsidiaries cannot do under the present setup.

After all, the only real fault, if it be a fault, to be found with the modified plan is that it does not permit the bondholders to appropriate all future profits to their exclusive use. On the other hand, they will get now just as much, if not more, under the modified plan as if there were now a foreclosure or a liquidation under 77B-(k).

There are certain economic factors involved. In view of the current business stagnation, it is important that all industry be encouraged. The likelihood of securing immediate contracts for the construction of naval auxiliary vessels and merchant ships, which will result in the employment of a large number of men not now employed, not only by the reorganized corporation but also by those who furnish materials and supplies, and which will cause the flow of large sums of money in the channels of trade in the local Los Angeles area, indicates that every effort should be made by the parties in interest here to effect a prompt reorganization. To that end the Court can well exercise the wide discretion given to it to confirm a plan

under Section 77B, even though under different economic conditions it might be hesitant to confirm a plan that takes in the old stockholders. Section 77B is of a remedial character, designed to facilitate the reorganization of corporate business made necessary by economic depression and its purpose should be forwarded by a fair and liberal construction, and not thwarted by any narrow or technical interpretation.

While the evidence in favor of permitting the old Class A stockholders, in view of the insolvency of the Debtor, to share on a stock basis with the bondholders, but in a minority and deferred position, might be stronger, the Special Master, after weighing carefully all of the factors involved, has concluded to recommend the approval of the modified plan by the judge. During the course of the hearings before the Special Master it was plainly indicated by objecting bondholders, Thomas K. Case and Adele M. Cowan, that a simple solution of the Debtor's problem would be the payment in full of their bonds and all other non-assenting bonds. While a court of equity will not allow minority bondholders to be disregarded or unfairly treated in a reorganization plan, yet, on the other hand, it will not lend its aid to schemes by minority bondholders opposing a fair reorganization plan solely as a means of obtaining greater value or more favorable terms for his bonds than are to be given by the plan to the great majority of bondholders. The cases on this subject are more or less rigid in their requirement that where insolvency exists the creditors must be fully compensated before old stockholders can be let into the picture at all. However, there are other ways of furnishing adequate compensation than by cash alone. The modified plan provides not only for placing the bondholders in a pre-

ferred position as to dividends and upon liquidation, but also for the reservation of a certain amount of Class A preferred stock to be held in the treasury for future use in the raising of money. The present bondholders, as new Class A stockholders, need have no concern over this reservation because their majority control of all of the stock will enable them to control the Board of Directors to the end that the use of this treasury Class A stock will be for wise and useful purposes for the benefit of all concerned. Nor need the bondholders, as the new Class A shareholders, be concerned over the possible creation of new liens against the assets in the new corporation, because such old bondholders, through such majority control, will have full say as to why, how, and when any such liens shall be created. It is true that the old Class A shareholders, the new Class B stockholders, by reason of their being in close touch with the business in the past and their present control of the corporation, may be able to organize more quickly and more concretely in controlling the policies of the new corporation than the old bondholders, the new Class A shareholders, since the latter are widely scattered and out of touch with the business. But this is a chance that the bondholders must take if the company is to be reorganized and put on its feet and not be subject to foreclosure or liquidation. The modified plan does not provide for cumulative dividends for the reason that if the business is not prosperous, or is only moderately prosperous, such arrangement might be detrimental.

III. FINDINGS AND CONCLUSIONS

From the evidence offered and received, the Special Master makes the following findings and conclusions:

1. It is for the best interests of the Debtor corporation and its subsidiaries, and all parties in interest, that the Debtor should not be continued in permanent possession of its assets, but that a permanent trustee should be appointed upon the nomination of the Debtor, preferably C. C. Spicer, the President of the Debtor corporation, who should act without compensation but should be placed by the Court under adequate surety bond for the faithful performance of his duties. In the event that C. C. Spicer is appointed such trustee, he should be permitted to continue as President and General-Manager of the Los Angeles Shipbuilding and Drydock Corporation, the Debtor's principal subsidiary, at not more than his present salary of $1,000.00 per month. Under existing circumstances, it may not be necessary, in the event of the appointment of such permanent trustee, for him to select as counsel any one who is not now serving as counsel for the Debtor. During the consummation of the reorganization it is unlikely that there will be any conflict of interest between the Debtor and the trustee. The expense of this procedure would be negligible inasmuch as such trustee would act without compensation, and his counsel would receive no more than if no such trustee were appointed and the Debtor continued in possession, and the only expense would be the cost of the surety bond, which would be at the rate of $1.00 per $100.00. No salaries or compensation are now being paid to the officers of the Debtor corporation or to any of the subsidiaries except the Los Angeles Shipbuilding and Drydock Corporation. With respect to that subsidiary,

the salaries now paid to its officers, viz., C. C. Spicer, President and General-Manager, $1,000.00 per month, J. B. Ingoldsby, $400.00 per month, and G. Sutherland, $600.00 per month, are reasonable for the services now being performed.

2. The Debtor corporation filed herein in good faith its original petition for corporate reorganization under Section 77B of the Bankruptcy Act.

3. All parties who have appeared herein have acted in good faith. The following persons have filed herein answers to the original petition, which in effect is also a petition for the confirmation of a proposed plan of reorganization:

Mae Justice Johnson, Mary O. Rivers, Edwin M. and Maude M. Rankin, C. W. Olson, Helen Avery Cameron, Emma L. Rooks, William Wildburger, Merritt W. Linscott, Anna Edge Linscott, through George R. Larwill and Frank L. Balthis, Jr;

Thomas K. Case, in propria persona;

William Schoenau, Jr., in propria persona.

With respect to the issues of fact raised by said answers of Thomas A. Ogden, et al, and of Merritt W. Linscott and Anna Linscott, the following is true and untrue:

(a) It is true that the outstanding capital stock of the Debtor corporation does not consist of 57,788 shares of Class A stock but does consist of 57,065.165 shares of Class A stock and 5112 shares of Class B stock.

(b) The Los Angeles Shipbuilding and Drydock Corporation is the only subsidiary corporation of the Debtor now being operated, and the officers and directors of said subsidiary and of the Debtor are substantially identical,

and the assets of said subsidiary are now being wholly managed and controlled, and the business of said subsidiary is now being entirely carried on by the Debtor corporation and its officers and directors.

(c) The plan of reorganization proposed by the Debtor in its original petition for corporate reorganization filed herein was not discussed with representatives of the Debtor's bondholders prior to its formulation and preparation, and said bondholders did not participate in the same, and such plan was entirely prepared and formulated by the present management of the Debtor representing the Debtor's present stockholders, and the only participation by bondholders in such plan was at hearings before the California State Corporation Commissioner on an application by the Debtor for a permit to solicit bondholders for their approval of the 1937 proposed plan, at which hearings objections were made on behalf of the bondholders and such plan was thereafter modified.

(d) The plan of reorganization proposed by the Debtor in its said original petition is not fair, equitable, feasible, and undiscriminatory in that it does not provide for full compensation to the creditors before the old stockholders are permitted to share in the reorganized company, in view of the insolvency of the Debtor corporation.

(e) The appointment of a permament trustee will be practicable and is necessary in order to protect the interest of the bondholders and other parties in interest. The only business of the Debtor corporation is not simply the holding of the stock of its subsidiary companies, but on the contrary the Debtor corporation manages and controls and carries on the business of its wholly owned subsidiary, the Los Angeles Shipbuilding and Drydock Corporation. It

is not for the best interest of all parties in interest that the Debtor corporation be permitted to continue in permanent possession of its assets.

(f) It is not true that during the year 1936, when the Armes contract was canceled and the 1930 reorganization abandoned to that extent, the management or control of the Debtor corporation reverted to the stockholders. It is true that under the Armes contract, he was given the right to vote 64,211 shares of Class A stock in the Debtor corporation, which represented the majority control, Class A and Class B, and that it was provided by the Armes contract and agreements collateral therewith that such stock should be held in trust by the Title Insurance and Trust Company, as trustee, and that in the event of the termination of the Armes contract, such voting control should pass to Peirce, Fair & Co., one of the original bond underwriting firms, but it is not true that such new voting control in Peirce, Fair & Co. should be for the benefit of the bondholders. There was no plan in 1936 or at any other time to take away control and management from the bondholders and give the same back to the stockholders, and while said Armes stock was released from escrow in 1936 by the said trustee, Title Insurance and Trust Company, and thereafter cancelled by the Debtor corporation, this did not eliminate any control or management which had been given to bondholders, because no such control and management had ever been given to bondholders. It is true that the said transaction vested complete control back in the hands of Class A stockholders under the 1930 reorganization scheme. The cancellation of such stock was either not in violation of the rights of bondholders under the 1930 reorganization scheme, or, at most, was only a technical violation, which did not materially or adversely

affect them. The effect and result of such cancellation of said Armes stock was not to take away the control and management of the Debtor corporation from the bondholders and place the same in the hands of the stockholders for the reason that the bondholders had never had the control and management of the Debtor corporation. The said George A. Armes was selected in 1930 to operate and manage the Debtor's business at the instance of the bondholders. Prior to the cancellation of said Armes stock, as aforesaid, said Armes had the control and management of the corporation by the following representation on the Board of Drectors: Messrs. Armes, McHose, Thatcher and Crowley, and the interests of the other stockholders were represented on such Board by Messrs. Spicer, Baker and Bagley. Upon the cancellation and termination of the Armes agreement and the cancellation of the Armes stock, the said Armes, McHose, Thatcher and Crowley resigned from the Board, and thereupon four additional members were appointed to the Board by said remaining directors, such additional members being: W. I. Hollingsworth and W. W. Powell, sponsored by stockholders, and David A. Faries and Harry W. Watson, sponsored by bondholders, and after such appointment, the Board of seven directors consisted of five directors sponsored by stockholders and two directors sponsored by bondholders, and such Board of Directors has ever since dominated and controlled the said corporation. These proceedings were not in violation of or contrary to the 1930 reorganization plan or any rights of bondholders.

(g) While it is true that the present Class A shareholders in the 1930 reorganization of the Debtor corporation paid in only $400,000.00 to the treasury, it is not true that this represents the only investment they and their

predecessors in interest made in the corporation, and it is true that the total investment made by these Class A shareholders and their predecessors in interest in the corporation from its beginning approximated the total amount invested by the bondholders.

(h) It is true that the consideration which moved the bondholders in the 1930 reorganization to withhold exercising their foreclosure rights at that time and eliminate from the management of the corporation the stockholders thereof was the payment of the said sum of $400,000.00 into the Debtor's treasury, for which the present Class A stock was issued. It is true that the Debtor corporation is insolvent in that the value of its assets is substantially less than the amount of its liabilities and in that the Debtor cannot continue to do business and meet its obligations.

4. With respect to the issues of fact raised by answer of Thomas K. Case, the following is true and untrue:

(a) It is true that the proposed plan of reorganization set forth in the Debtor's original petition herein and the modified plan affect materially and adversely the interests of Thomas K. Case as a bondholder, in that the face value thereof is depreciated, but neither plan is discriminatory as between the said Thomas K. Case and the other holders of bonds. As to Thomas K. Case, as a bondholder, the modified plan of reorganization is fair, equitable, feasible, and not discriminatory.

(b) The Debtor's original petition herein for reorganization states facts sufficient to warrant the granting of relief prayed for therein, and the Debtor corporation is both in a legal and equitable position to claim all of the benefits of Section 77B of the Bankruptcy Act.

(c) It is not true that the Debtor corporation sets up as its only indebtedness that due the bondholders. The said Debtor corporation also sets up as an indebtedness debts of current accounts payable $6,075.94, and an account payable to the Los Angeles Shipbuilding and Drydock Corporation of $496,890.76.

(d) The plan proposed in the said original petition and the modified plan do not seek to subject the bonds and the secured lien thereby created to cancellation and the consequent loss of said lien without due process of law.

(e) The proposed plan of reorganization set up in the original petition filed herein and the modified plan would each deprive the bondholders of their liens, but the modified plan would substitute for said liens stock in a reorganized corporation upon a fair, equitable, feasible, and undiscriminative basis as between all bondholders.

(f) While it is true that the bondholders would be deprived by each of such plans of their rights flowing from said contracts to retain their liens until the indebtedness secured by the Trust Indenture has been paid, and the right to realize upon such security by a judicial sale, and the right to determine when such sale shall be held, subject only to the discretion of the Court, and the right to protect their interests in the property by bidding at such sale, and the right to have the proceeds devoted primarily to the satisfaction of the debt, and the right to control the property meanwhile during the period of default, subject to the discretion of the Court, and the right to have the rents and profits during such period applied to the satisfaction of such debt, all of these rights are subject to the provisions of Section 77B of the Bankruptcy Act and subject to modification provided the plan of reorganization, as in the instance case the modified plan, is fair,

equitable, feasible, and nondiscriminatory among the members of each class of creditors, such as the class of bondholders in the case at bar. The modification proposed of such property rights so enumerated is not contrary to law and equity; and such modified plan does not violate Amendment No. V to the Constitution of the United States of America. Such modified plan impairs the obligation of contracts under the provisions of the Fourteenth Amendment to the Constitution of the United States of America, but such Amendment affects only the power of the States to impair the obligation of contracts and does not impair the right of Congress to legislate upon the subject of bankrupties pursuant to the power conferred upon it by Article I, Section 8, clause 4, of the said Constitution.

(g) The original petition filed herein by the Debtor does not show that the Debtor corporation has no creditors it cannot pay and that its only indebtedness is that represented by a small number owners of a small number of undeposited bonds who have always retained possession thereof and are now dissenting creditors, but, on the contrary, the said petition and the evidence shows that the Debtor corporation has creditors which it cannot pay and its indebtedness is represented by liabilities to bondholders in the sum of approximately $3,807,071.88, principal and interest; for current accounts payable, $6,075.94; and for an account payable due the Los Angeles Shipbuilding and Drydock Corporation, $496,890.76.

(h) It is not true that the shares of capital stock proposed to be issued in lieu of bonds, under either the plan proposed in the original petition or the modified plan, would have no market or other value, but on the contrary such stock would have a definite if not a market value in

view of the fact that the new corporation under the reorganization would have assets of several hundred thousand dollars without any liens thereon.

(i) It is not true that the only unpaid outstanding bonds not deposited pursuant to the Trust Agreement dated April 1, 1930, between D. G. Sherwin, C. F. Seidel, C. J. Lennihan, Jr., George R. Martin, and James E. Dorsey, as Trustors, the Parties of the First Part, and Security-First National Bank of Los Angeles, Trustee, the Party of the Second Part, and the Debtor corporation, as the Party of the Third Part, represent a par value of approximately $56,000.00, but it is true that such bonds represent a par value of approximately $66,000.00. It is not true that such indebtedness constitutes the only indebtedness of the Debtor corporation. It is not true that 97%, or any percentage, of the total number of issued bonds, or any percentage, or any bonds, of the total number of issued bonds belong to the Debtor corporation or to the Trustee named in the trust deed securing the bonded indebtedness, or that the owners of any of said bonds have sold, assigned, and transferred all or any of their right, title, or interest in said bonds, to the Debtor.

(j) It is not true that the Debtor corporation and/or any Bondholders Protective Committee thereof, and/or, Security-First National Bank of Los Angeles, the trustee named in the Trust Indenture securing said bond issue, have purchased or now own approximately $2,509.500.00 par value of $2,565,500 00 principal amount of bonds outstanding, but on the contrary the said corporation and the said Bondholders Committee and the said trustee each and all of them have not purchased and do not own any of such bonds, except that Security Company, an affiliate of

the trustee under the Trust Indenture, now holds $676,500.00 of the bonds.

(k) It is not true that the Debtor corporation alone knows, and has exclusive knowledge of, who and how many of the bondholders, depositing under said Trust Agreement, have purchased the capital stock of said corporation, and/or, accepted the same as a consideration for their bonds, or that the Debtor corporation has withheld from the Court, or any one, the necessary or any information to show what bondholders, if any, have surrendered their bonds, and/or, have assigned their interest therein to the Debtor or to its treasury, or that the Debtor corporation has withheld from the Court, or from any one else, the names of the owners and amounts of bonds who have not deposited their bonds under said Trust Agreement, or that those who have not so deposited said bonds are the only owners of the secured liens upon the properties pledged in the Trust Indenture; but, on the contrary, none of the bondholders herein have waived their security under said Trust Indenture, whether such bondholders have deposited their bonds under the said Trust Agreement and received trust certificates therefor, or whether such bondholders have not deposited their bonds under such Trust Agreement, and the security for all of the bonds as created by said Trust Indenture is still in full force and effect.

(l) It is not true that the Debtor corporation, without right or authority of law, or otherwise, issued and delivered without consideration to many of the former bondholders, who were induced to deposit their bonds with it, several thousand shares of either Class A or Class B capital stock under the 1930 reorganization to induce them

to assign their bonds to the Debtor, or to said trustee under said Trust Indenture and to consent to have them cancelled, and that said former bond owners are estimated in the said plan proposed in the said original petition to be stockholders entitled to distribution to them of capital stock to be issued under the proposed plan of reorganization; but, on the contrary, none of the bondholders have ever deposited or surrendered their bonds to the Debtor corporation or to the trustee under the Trust Agreement of April 1, 1930, nor have any of said bondholders assigned their bonds to the Debtor corporation, or to the said trustee, except that 97% of the bondholders, pursuant to the Trust Agreement of April 1, 1930, transferred the legal title of their bonds to said trustee, viz., Security-First National Bank of Los Angeles, in trust for the purposes specified in said Trust Agreement, but in doing so retained and now hold the equitable title to such bonds so deposited, and received trust certificates as evidence thereof.

(m) It is not true that the Debtor corporation, without right or authority of law, paid money or any thousands of dollars of the Debtor's to George A. Armes, or that during the year 1936 paid to George A. Armes the additional sum of approximately $25,000.00 or more for the cancellation of his contract with the corporation created in 1930, or that such contract contemplated any illegal acts; but, on the contrary, such contract was entered into fairly and without fraud and at the instance of approximately 97% of the bondholders, represented by a Protective Committee, and while the same did not work out satisfactorily from a business point of view, this result was not the fault of the Debtor corporation or its officers and directors, and the settlement made by the Debtor corpora-

tion with George A. Armes in 1936, wherein and whereby George A. Armes was paid $28,000.00 in full satisfaction of a possible liability of $96,000.00, was for the best interests of the Debtor corporation and all of its creditors and stockholders.

(n) It is not true that the Debtor is able to meet its debts as they mature and that Debtor is able to pay the obligation on its outstanding bonds and indebtedness, and that the assets pledged in the trust deed as security for the bonded debt have a value in excess of the liability thereunder.

(o) It is true that the Debtor corporation effected in 1930 a reorganization under the terms of which stockholders' liabilities as to certain old stockholders was waived, and that Thomas K. Case did not consent directly to such reorganization; but he is bound thereby under the provisions of Section 9 of Article 11 of the Trust Indenture securing the bonds, in that the requirements thereof were fully complied with in effecting such reorganization; and such compliance with the terms of said Section 9, of Article 11, bound said Thomas K. Case as well as all other bondholders.

(p) It is true that the sinking fund requirements of the said Trust Indenture have not been complied with for many years and were not promptly complied with prior to the first default of the Debtor corporation under the Trust Indenture on February 1, 1929.

(q) It is true that the Debtor corporation is now and since the year 1925 has been acting as a holding corporation, owning and holding all of the capital stock of the subsidiary corporations mentioned in the said original

petition for reorganization filed herein, but it is not true that the Debtor corporation is illegally incorporated.

(r) It is true that ever since the incorporation of the Debtor, Daniel Murphy, of Los Angeles, has been a large stockholder of the same and has acted as director thereof personally and through his agent and employee H. K. Bagley, and that the said Daniel Murphy is now and for many years last past has been a director of Security-First National Bank of Los Angeles, the trustee named in the said Trust Indenture, and that the said Daniel Murphy has been and now is a dominant factor in said Bank and in the Debtor corporation, and that for a consideration of $200,000.00, or thereabouts, paid into the Debtor corporation as a part of the $400,000.00 contributed by stockholders in the 1930 reorganization, the said Daniel Murphy received a release from stockholder's liability and 21,670.50 shares of Class A stock of the Debtor corporation issued under the 1930 reorganization. It is not true that such exemption from stockholder's liability was illegal and without authority of law, either so far as the said Thomas K. Case is concerned or otherwise, or that said stockholder's liability still exists in the event of a deficiency claim which might accrue under the Trust Indenture after a judicial sale of the assets pledged in the Trust Indenture, and that such claim is a valuable and substantive right possessed by the said Thomas K. Case, but it is true that if there were any such right to a deficiency claim, the same will be taken away from the said Thomas K. Case in the event of a reorganization herein as proposed. The said Thomas K. Case has never released or assigned any such right directly but has done so indirectly pursuant to the provisions of Section 11 of Article 9 of the said Trust Indenture as above related.

(s) It is true that Thomas K. Case purchased all of the bonds now held by him prior to the year 1930, and that during 1930 the Debtor corporation was reorganized and thereafter supplements to the Trust Indenture were entered into pursuant to the provisions of Section 11 of Article 9 of said Trust Indenture. It is not true that all or any of such procedings were unilateral, inequitable, and unfair as to Thomas K. Case, or as to any other creditor and were made without the consent or knowledge of the said Thomas K. Case. The said proceedings and the supplements to the Trust Indenture, the first supplement being dated April 1, 1930, the second being dated February 1, 1932, and the third being dated August 10, 1933, and the Trust Agreement dated April 1, 1930, which documents have been received herein as evidence in the form of Debtor's Exhibits F, G, H, and I, are, with the exception of the said Trust Agreement, effective as to the said Thomas K. Case and binding upon him and are not illegal and without authority of law or equity and do change the contractual relations created by the original bonds and original Trust Indenture securing the payment of the same, for the reason that said supplements to said Trust Indenture were created and executed in due course pursuant to the provisions of Section 11 of Article 9 of the original Trust Indenture and the terms of the bonds themselves, under which provisions the said Thomas K. Case was bound the same as all other bondholders.

5. With respect to the issues of fact raised by the petition filed herein by William Schoenau, Jr., a bondholder, for a change of the plan of reorganization, the following is true and untrue:

(a) While it is true that there is no asset equity in the Debtor corporation for the old stockholders, either those

owning Class A shares or those owning Class B shares, since the Debtor corporation is insolvent, it is not true that for that reason alone the owners of such shares are not entitled to receive any stock or other interest in the reorganized company. It is not true that the owners of Class A stock have heretofore received adequate consideration for the money paid by them for such Class A stock, nor is it true that the bondholders have received adequate consideration for the money paid by them for the said Bonds, nor is it true that the sole consideration for the payment of $400,000.00 into the corporation by the Class A shareholders in 1930 was a release of stockholders' liability. The said release of such stockholders' liability was only a part of such consideration and an inducement to such shareholders to so subscribe such money. Other considerations and inducements were the waiver by the bondholders of the right to foreclose until the year 1944, when the bonds matured, the reduction of interest on the bonds from 7½% to 6% per annum, and the limitation of payment of such interest to funds derived from net income. It is not true that the exclusion of Class A stockholders from sharing in the proposed reorganization herein and thus securing the deposit of additional bonds in favor of a plan of reorganization would improve the credit of the reorganized corporation.

6. The Debtor corporation is insolvent in the bankruptcy sense, i. e., in that its assets at a fair valuation are insufficient to pay its debts, and in the equity sense, i. e., in that it is unable to pay its debts in the ordinary course of business as they mature.

7. No claims filed herein, either of creditors or stockholders, have been objected to by any of the parties in

interest, nor is the Special Master aware of any such claims so filed that are invalid.

8. With respect to the modified plan of reorganization now proposed herein by the Debtor, the Special Master finds:

a. The same has been filed in good faith.

b. The same is fair and equitable.

c. The same does not discriminate unfairly against any creditor or stockholder or any class or group of creditors or stockholders.

d. The said modified plan is feasible.

e. The said modified plan complies with subdivision (b) of Section 77B of the Bankruptcy Act.

f. The said modified plan has been accepted as required by subdivision (c) of Clause (1) of Section 77B of the National Bankruptcy Act.

g. All of the provisions of subdivision (c) of clause (2) of Section 77B of the National Bankruptcy Act have been complied with.

IV. MOTIONS AND OBJECTIONS.

1. Thomas K. Case objected throughout the proceedings before the Special Master to the jurisdiction of the Court to grant the relief prayed for in the original petition filed by the Debtor for corporate reorganization upon the ground that such petition does not state facts sufficient to warrant the granting of the relief prayed for therein and that the Debtor is not in a legal or equitable position to claim any of the benefits of the Bankruptcy Act of the United States, including Section 77B of that Act, particularly in view of the estoppel created by Sec-

tion 5, Article II, page 29, of the Trust Indenture. The Special Master overruled this objection upon the ground that the objection was not well taken in view of the pleadings and the evidence; and Article II, Section 5, page 29, of the Trust Indenture is void and unenforceable upon the ground of public policy.

2. Thomas K. Case moved to strike out Exhibits F, G, and H, the supplements dated April 1, 1930, February 1, 1932, and August 10, 1933, to the original Trust Indenture, Debtor's Exhibit E, dated March 8, 1924, upon the ground that they were not binding on him or other bondholders who, like him, did not consent thereto, and he and the other nonassenting bondholders with a total face value of $66,000.00 in bonds had the right to treat them as now in default. The Special Master overruled this motion upon the ground that Case and such nonconsenting bondholders were bound by these instruments in view of the provisions of Article IX, Section 11, page 79, of such Trust Indenture (Debtor's Exhibit A), and that such supplements thereto were duly executed pursuant to such provisions.

3. Thomas K. Case moved to strike out Debtor's Exhibit I; the Trust Agreement of April 1, 1930, whereby bonds were to be deposited with a special trustee for specified purposes, upon the ground that he was not a party thereto and did not consent to the same. The Special Master denied this motion upon the ground that while this trust agreement might not be material as to him it was material as to other parties to the proceeding.

V. RECOMMENDATIONS

The Special Master recommends as follows:

1. A Permanent Trustee be appointed herein for the Debtor corporation to act during the proceedings herein, such Trustee to be placed under an adequate bond, the amount thereof to be fixed by the Court, and in this respect the Special Master suggests that the bond be fixed in the sum of $50,000.00. Such a Trustee, if he is C. C. Spicer, the present President of the Debtor corporation and of its subsidiary, the Los Angeles Shipbuilding and Drydock Corporation, can act without compensation other than the compensation he receives as President of the Los Angeles Shipbuilding and Drydock Corporation. It is the opinion of the Special Master that it is for the benefit of all parties in interest herein that a Trustee be appointed in such a manner because little additional expense will be involved. The cost of a surety bond which will be small commensurate with the protection given creditors, and they will have an adequate source of recoupment in the event that there is any mismanagement or maladministration. Such bond should be in the usual form of bonds in bankruptcy proceedings, as provided by Section 50-b of the Bankruptcy Act, for the faithful performance by such Trustee of his official duties. If the Debtor is permitted to remain in permanent possession and to operate the business of the Los Angeles Shipbuilding and Drydock Corporation during these proceedings through its control of the capital stock of such subsidiary, the creditors will not have the ordinary protection against negligence and maladministration provided for them under the provisions of the Bankruptcy Act in connection with ordinary bankruptcy proceedings.

2. The modified plan of reorganization as set forth herein be confirmed by the Court as fair, equitable, feasible and not discriminatory as to any class of creditors or any member of any class of creditors.

3. George R. Larwill be appointed a director of the new corporation under the modified plan of reorganization, the others to be six of the present Board of the Debtor, the same to be determined upon by such Board, and to act until the election of a new Board of the new company, as provided in the modified plan.

4. An election be held under the supervision of the Court, within ninety days of the confirmation of the modified plan, of a new Board of Directors of the reorganized corporation, and in such election the Debtor corporation and its officers and directors be required to remain neutral.

5. The Court shall retain jurisdiction of the proceedings until the modified plan has been fully consummated and the said new Board of Directors has been elected and have entered upon their duties and are proceeding to operate the Debtor's business.

6. The assets of the Masset Timber Company, Ltd., and the Puget Sound Lumber and Box Co., be sold in these proceedings as soon as practicable, by the Debtor corporation or by any Trustee who may be appointed, under the supervision of the Court pursuant to the power conferred upon this Court by the Amendment made on August 12, 1937, of subdivision (c) of Section 77B through the addition thereto of paragraph (3½), and pursuant to the requirements of General Order No. LII,

paragraph 4, of the Supreme Court of the United States relating to Bankruptcy, which paragraph was added on November 16, 1937.

VII. LIST OF EXHIBITS

The following exhibits were received in evidence before the said Special Master and are transmitted herewith:

PETITIONING DEBTOR'S EXHIBITS:

A-1 Lybrand, Ross Bros. & Montgomery report upon examination of accounts and financial records for period ending June 30, 1936,

A-2 Lybrand, Ross Bros. & Montgomery report upon examination of accounts and financial records for period ending December 31, 1936.

B Status of securities outstanding deposited and undeposited in connection with plan of reorganization dated May 24, 1937.

C Statement showing salaries to the company's management, including officers and operating manager, by positions, dated June 30, 1936, and subsequent.

D Estimated annual expenses for shutdown properties, December 31, 1936.

E Original Trust Indenture dated March 8, 1934.

F Supplemental Trust Indenture dated April 1, 1930.

G Second Supplemental Trust Indenture dated February 1, 1932.

H Third Supplemental Trust Indenture dated August 10, 1937.

I Trust Agreement dated April 1, 1930 between D. B. Sherwin, C. F. Seidel, C. J. Lennihan, Jr., George R. Martin and James E. Dorsey, trustors, Security-First National Bank of Los Angeles as trustee, and Los Angeles Lumber Products Company, Ltd., as party of the third part.

J Two pages, one titled "Los Angeles Shipbuilding & Drydock Corporation, profit and loss account, January 1, 1937 to December 31, 1937, based on appraisal of June 30, 1936"; the other titled "Los Angeles Shipbuilding & Drydock Corporation, comparative profit and loss statement for 12 months ended December 31, 1937, with 12 months ended December 31, 1936, assuming that the above periods were operating under the reorganization as planned."

K Document consisting of 2 typewritten pages, entitled "Los Angeles Lumber Products Company, Ltd. and subsidiaries, statement of working capital available as at May 1, 1930, comparative with working capital available as at June 30, 1936.

L Document consisting of 1 typewritten page, Los Angeles Shipbuilding & Drydock Corporation, source and use of funds, July 1, 1936 to December 31, 1937.

M Blueprint of the Los Angeles Shipbuilding & Drydock Corporation's property at Los Angeles Harbor.

INTERVENING CREDITORS' EXHIBITS

1 Letter from Bondholders' Protective Committee to bondholders dated February 17, 1930.

2 Declaration of Trust dated January 16, 1930, between Title Insurance & Trust Company, Los Angeles Lumber Products Company and G. A. Armes.

3 Agreement terminating Declaration of Trust.

4 Minutes of adjourned meeting of board of directors of Los Angeles Lumber Products Company of June 29, 1936.

DISSENTING SECURED CREDITOR CASE'S EXHIBITS

A Memoranda made by Mr. Case.

B Bondholders' Protective Agreement of August 5, 1929.

C Circular of Los Angeles Lumber Products Company, Ltd. dated March 20, 1934.

D Circular of Los Angeles Lumber Products Company, Ltd. dated March 19, 1935.

Dated this 8th day of April, 1938.

Reuben G. Hunt
SPECIAL MASTER

[Endorsed]: Filed R. S. Zimmerman, Clerk, at 12 min. past 12 o'clock Apr. 8, 1938 p. m. by M. J. Sommer, Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

EXCEPTIONS AND OBJECTIONS TO REPORT OF SPECIAL MASTER.

Thomas K. Case, a secured and dissenting creditor of the above named Debtor, hereby objects and excepts to the Report and Findings of Hon. Reuben G. Hunt, Special Master herein, filed by him on the 8th day of April, 1938, and presents herewith the following exceptions to said Report and the grounds thereof, to-wit:

—I—

The Special Master's determination, lines 9-12, page 13 of his report, that "the bonds will not be in default until "that year (1944) and in the meantime there cannot be "any foreclosure because there will not be any default in "payment of interest",

is not supported by the evidence and is contrary to equity and to the law applicable to this case. Payment of interest is in default as to all bondholders. No interest whatever has been paid to dissenting bondholders since February 1st, 1929. The only interest paid to depositing bondholders was for two months or some small period of time and that was through the medium of shares of Class B. capital stock delivered to them;

—II—

The Master's determination on line 4, page 17 of his Report that "the new stock is to be non-assessable", has no support in the evidence, there is no offer in the Plan or amendment to that effect, the Finding by the Master in that respect has no legal efficacy to bind the Debtor and is contray to law and equity;

—III—

The Master's determination, on lines 6-8, page 18 of his Report that "The financial investment from the be-"ginning of these (present) stockholders etc. * * * "and the bondholders, has been approximately equal in the "sum of $2,500,000, for each class", is not supported by the evidence and is without foundation in fact;

—IV—

the same exception is taken to the same assertion in paragraph I., page 21 of the Master's report and on the same ground that it has no support in the evidence and is without foundation in fact;

—V—

that paragraphs 2, 3 & 4 on page 21 of the Report and lines 1 to 5, page 22, are incompetent, immaterial, argumentative and conjectural; with all the vaunted experience of the present stockholders, the experience of the bondholders has been one of injustice and of grief and tends to contradict said assertions; that the payment of interest last made on said bonds on February 1st, 1929, was several months prior to the break in the stock market and the beginning of a depression commencing with October 29th, 1929;

—VI—

that paragraph 5, page 22, of the Report, is without foundation in the evidence, is contrary to the evidence, is without foundation in fact, is incompetent and immaterial, is argumentative and conjectural; and contrary to law and equity;

—VII—

that paragraphs 6 and 7, page 22 of the Report, are not supported by the evidence, are contrary to law and

equity, are incompetent and immaterial, conjectural and argumentative;

—VIII—

that the Master's determination on lines 9 & 10, page 23 of his report that "the bondholders are given 77% as against 23% in the old stockholders", is not correct and that a much larger percentage would become available to the present stockholders with 170,000 shares of the new capital stock, and his conclusion is not supported by the evidence and is incompetent under the law of this case;

—IX—

Exception is taken to the analysis of the special master of the "modified plan", page 24 of his report, as incomplete in several respects, among them that it does not mention or take into consideration the fact that only the "principal" due on the bonds is contemplated, that there is no allowance for unpaid interest since February, 1929, at 7½ per cent promised in the bonds, no mention is made and no consideration had of the additional 170,000 shares of capital stock as the balance of the million shares, nor does it contemplate the retention by the Debtor of all of the assets pledged under the bond issue, nor does it distinguish between the dissenting bondholders and the depositing (possibly consenting) bondholders;

—X—

that the Master's conclusions, lines 26 to 31, page 27 and lines 1 & 2, page 28, of his report ending with "finally die through dry rot", are contrary to the law and the evidence and are incompetent and immaterial;

—XI—

that lines 12 to 14, page 28 of the Report represent a conclusion not supported by the evidence, is placed upon an erroneous construction of the law and does not contemplate the fact that the bondholders would receive no cash for principal or for interest, due on the bonds but only shares of a new corporation's capital stock having no market value and probably no other value, subject to assessment and the creation of a new bonded debt and other senior liens;

—XII—

that lines 15 to 32, page 28, all of page 29 and lines 1 to 17 of page 30, as well as other pages of said Report, are devoted largely to argument in the sole effort to indicate an "equity" in the present stockholders, part of it is contrary to the evidence, it is incompetent, conjectural and opposed to law and equity;

—XIII—

that the Special Master's conclusion on page 7, lines 16 and 17, that the Harbor lease for which Debtor is paying $21,500. per year "has probably no realizable value for creditors in the event of a liquidation", is without foundation in fact, there is no evidence to support such a conclusion by him and is contrary to law and equity;

—XIV—

exception is taken to the Special Master's conclusions stated by him on page 8, lines 27 to 33, on page 9, lines 28, 29 & 30, and on page 10, lines 13 to 17, as based upon his conjecture of what could be done by way of repairs and improvements which he holds are necessary and

where no money for such work is provided and is based upon his theory that there is a possible "equity" in the present stockholders and is therefore incompetent and immaterial and contrary to law and equity;

—XV—

exception is taken to Finding No. 1 of the special master, on pages 30 and 31 on his report on the grounds that said finding is not supported by the evidence, is based upon conjecture and is contrary to law and equity;

—XVI—

exception is taken to Finding No. 2 on page 31 of the report of the Master on the grounds that it is not justified by the evidence or by the law applicable to this matter and that his finding of "good faith" is contradicted by the evidence;

—XVII—

exception is taken to that portion of Finding 3, page 31, in so far as it concedes "good faith" to the Debtor herein and exception is taken to paragraph (h) on page 35 of said report on the grounds that in both instances the same are contrary to the evidence, there is no evidence on which to found said conclusions and that both are contrary to law and equity;

—XVIII—

exception is taken to the Finding of the Special Master on page 35, the last portion of paragraph (a) thereof, that

"As to Thomas K. Case, as a bondholder, the modified plan of reorganization is fair, equitable, feasible and not discriminatory" on the grounds that said finding is not supported by the evidence, is contradictory to the evidence and opposed to law and equity;

—XIX—

exception is taken to the finding of the Master in paragraph (b), lines 27-31, page 35 of his report, on the ground that the same is contrary to the evidence and to the law and equity applicable to this case;

—XX—

exception is taken to the finding of the Master in paragraph (c) at the bottom of page 35 and lines 1 to 4, page 36 of his report on the ground that the same is contrary to the evidence, is contradicted by the petition of debtor, is contradicted by another portion of the master's report (lines 22-24, page 12) and is contrary to law and equity;

—XXI—

exception is taken to the finding of the Special Master, paragraph (d), page 36 of his report, on the grounds that the same is contrary to the evidence, is contradicted by the Plan of Debtor and as amended, and is opposed to law and equity;

—XXII—

exception is taken to the closing portion of paragraph (e), pages 36 of the report, lines 13 & 14, comprising "upon a fair, equitable, feasible and undiscriminative basis as between all bondholders", upon the grounds that the same is contrary to the evidence and to the law and equity applicable to this case;

—XXIII—

exception is taken to that portion of the Report comprehending the last portion of paragraph (f) lines 27 to 33, page 36 and the rest of that paragraph (f) on page 37, lines 1 to 8 thereof, on the grounds that the same is contradicted by the evidence and by the decisions of

the Supreme Court and of the Circuit Courts of Appeals and upon the ground that Congress has not legislated upon the subject matter therein referred to;

—XXIV—

exception is taken to paragraph (g) of the Master's report on page 37, on the grounds that the same is contrary to the evidence, to the Petition and to the Plan of Debtor and opposed to law and equity and that while said finding does determine that there is a liability to the bondholders for "principal and interest", the amount of said interest is not correctly estimated and is opposed to the evidence in the case;

—XXV—

exception is taken to paragraph (h) on page 37 of the master's report, on the grounds that the same is opposed to the evidence showing that said capital stock proposed to be issued, has no market, and no other, value, that said corporation has long been in bad repute, has been partially investigated by the Sabbath Congressional Investigation Committee of Congress and is still subject to and will further be investigated by said Congressional Committee, none of which evidence has been contradicted, and upon the further ground that the set-up contemplated by the plan, leaves debtor in the position of again creating a bonded debt issue and creating senior liens against said capital stock and that said corporation having once tried to cancel the first and original mortgage lien, might well be supposed to try the same process a second time and upon the additional ground that said debtor having failed in business may be presumed to do so again, that said shares of capital stock could not qualify for enlistment on the stock exchanges and secure the necessary permit of the S. E. C. Commission of the United States

Government, and for many other reasons showing said shares of proposed capital stock, to be without value;

—XXVI—

exception is taken to that portion of the master's report, paragraph (i), lines 5 to 11, page 38, on the grounds that the same is contrary to the evidence, contrary to and does not cover the allegation in Case's Answer and Opposition herein and is contradicted by documentary evidence in this case;

—XXVII—

exception is taken to that portion of the master's report, in paragraph (j), page 38, lines 17 to 19 thereof, on the ground that the same is contradicted by the evidence in the case;

—XXVIII—

exception is taken to that portion of the master's report comprehending paragraph (k), lines 22 to 32, page 38 and lines 1 to 9 on page 39, on the ground that the same is contrary to the evidence in the case;

—XXIX—

exception is taken to that portion of the master's report in paragraph (l), lines 29 to 31, page 39, on the ground that the same contradicts the evidence in the case;

—XXX—

exception is taken to that portion of the master's report, paragraph (m) on page 39A, lines 6 to 15 thereof, on the ground that the same is contrary to the evidence;

—XXXI—

exception is taken to that portion of the master's report, paragraph (o), lines 25 to 30, page 39A, on the ground that the same is contrary to law and equity and not supported by the evidence;

—XXXII—

exception is taken to that portion of the master's report on page 41, lines 3 & 4, paragraph (r), on the ground that the same is contrary to law and equity;

—XXXIII—

exception is taken to that part of the master's report comprehending paragraph (s), page 41, lines 9 to 27 thereof, on the ground that the same is contrary to law and equity; and not supported by the facts in the case;

—XXXIV—

exceptions were taken by Thomas K. Case, shown in the record, and are again taken herewith, to the rulings of the special master as shown in his report, page 43, lines 16 to 32 and on page 44, lines 1 to 18, and this creditor excepts to each and all of said rulings;

—XXXV—

exception is taken herewith to the "Recommendations" of the special master, specifically to Recommendations Nos. 2, 4, 5 and 6, on pages 45 and 46 of his report on the grounds that the same are contrary to the law and equity applicable to this case, are not justified by the facts in this case and are based upon his incorrect construction of 77 B. of the Bankruptcy Act, of the decisions of the Courts of the United States and all law applying to this case.

WHEREFORE, this dissenting creditor requests that the report of the special master and his recommendations therein contained, be rejected and denied.

Dated April 14th, 1938, the District Court having extended the time for these exceptions to this date.

Thomas K. Case
Secured & Dissenting Creditor,
In Propria Persona.

[TITLE OF DISTRICT COURT AND CAUSE.]

EXCEPTIONS AND OBJECTIONS TO REPORT OF SPECIAL MASTER BY ADELE B. COWAN

COMES NOW ADELE B. COWAN, a secured creditor and dissenting bond holder, and joins in the Exceptions and Objections filed herein by Thomas K. Case, likewise a secured creditor and dissenting bond holder, and adopts each and all of said Exceptions and Objections as her own and requests the court to reject the report of the Special Master and deny the recommendations therein contained.

Dated: April 15, 1938.

Clarke & Bowker
Earl E. Moss
Attorneys for Adele B. Cowan

United States of America,)
Southern District of California,)
County of Los Angeles,) ss:
State of California.)

I, Thomas K. Case, the secured creditor mentioned in the foregoing Exceptions to the Report of the Special Master appointed by the Court herein, being duly sworn, depose and say that I have read said Exceptions to said Report and know the contents thereof; that the same are true of my own knowledge and that as to all statements of fact therein contained, I believe them to be true.

Thomas K Case

Subscribed and sworn to before me this 14th day of April, 1938.

[Seal] Joseph P. Johnston
Notary Public in and for the County of Los Angeles, State of Californ.

My Commission Expires August 27, 1941

[Endorsed]: Filed R. S. Zimmerman Clerk at 50 min. past 12 o'clock Apr. 15, 1938 P. M. By F. Betz Deputy Clerk.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF CALIFORNIA CENTRAL DIVISION

IN THE MATTER OF	No. 31,352 R. J.
LOS ANGELES LUMBER PRODUCTS COMPANY, LTD, a corporation,	INTERLOCUTORY ORDER CONFIRMING PLAN OF REORGANIZATION.
DEBTOR,	

In the above entitled matter the Petition of Debtor for an order continuing Debtor in possession of its property and assets came on for hearing on February 28, 1938, before the Honorable R. E. Jenney, United States District Court Judge and was continued for hearing to March 21, 1938. The said hearing and the hearing for the proposal, consideration and confirmation of the Plan of Reorganization of Debtor came on regularly for hearing on March 21, 1938, before the Honorable R. E. Jenney, Judge of the Court. Said hearings having been duly continued to April 11, 1938, and prior thereto and on or about March 18th, 1938, a modification of said Plan of Reorganization having been proposed and filed herein by Debtor and set for hearing by order of Court on April 11, 1938 (said Plan of Reorganization and modification thereof being hereinafter referred to as the "Plan") and said matters having come on regularly for hearing on said date and having been continued from time to time pursuant to order of this Court, were concluded on April 22nd, 1938. At said hearings the following appeared:

Faries & McDowell by J. Clifford Argue and David R. Faries and Gibson, Dunn & Crutcher by J. C. Macfarland as counsel for Debtor.

Thomas K. Case, bondholder, in propria persona, holding Thirteen Thousand Five Hundred ($13,500.00) Dollars principal amount of bonds.

George R. Larwill and Frank S. Balthis, Jr., on behalf of Thomas A. Ogden, May Justice Johnson, Mary O. Rivers, Edwin M. Rankin and Maude M. Rankin, C. W. Olsen, Helen Avery Cameron, Emma L. Rooks, Merritt W. Linscott and Anna Edge Linscott and William Wildburger, bondholders holding Thirty-three Thousand ($33,000.00) Dollars principal amount of bonds.

William Schoenau, Jr., bondholder, in propria persona, holding Twelve Thousand Five Hundred ($12,500.00) Dollars principal amount of bonds.

Clarke & Bowker and Earle E. Moss on behalf of Adele M. Cowan, bondholder, holding Five Thousand ($5,000.00) Dollars principal amount of bonds.

Overton, Lyman & Plumb by C. L. McGaughey on behalf of Charlene Coulter and Mary E. Priest, bondholders, holding Fourteen Thousand Five Hundred ($14,500.00) Dollars principal amount of bonds.

Upon consideration of the evidence and testimony presented before the Special Master and the Report and Recommendation of the Special Master and all exhibits and other proof introduced in this cause and all acceptances, petitions, orders and proceedings herein, and this Court having heard the arguments of counsel and the matter having been submitted to the Court for decision;

THE COURT FINDS:

(1) That Los Angeles Lumber Products Company, Ltd., herein called the Debtor, is a corporation organized and existing under the laws of the State of California and that its principal place of business is and has been during the six months preceding January 28, 1938, in the City of Los Angeles, County of Los Angeles, State of California, which is in the territorial jurisdiction of this United States District Court for the Southern District of California, Central Division, hereinafter sometimes referred to as Court and that it has had its principal assets, both in extent and value, within the boundaries of said judicial district six months preceding January 28, 1938.

(2) That Debtor has not been adjudicated a bankrupt and no prior proceedings involving the sequestration of Debtor's assets is pending in any Court.

(3) That Debtor's principal assets consist of the ownership of all of the capital stock of Los Angeles Shipbuilding and Drydock Corporation. That said subsidiary corporation is engaged in the shipbuilding and ship repair work at Los Angeles Harbor, San Pedro, California. That neither the Debtor, nor any of its subsidiaries are utility corporations subject to the jurisdiction of the regulatory commission or commissions or other regulatory authority or authorities created by the laws of the State or States in which any properties of the Debtor or its subsidiaries are operated.

(4) That on or about January 28, 1938, Debtor herein filed its Petition for a Reorganization under and pursuant to the provisions Section 77B of an Act of Congress approved July 1st, 1898, entitled "An Act to Es-

tablish a Uniform System of Bankruptcy Throughout the United States and Acts Amendatory Thereof and Supplementary Thereto" (said Act being hereinafter referred to as the "Bankruptcy Act" and said Section 77B being hereinafter referred to as "Section 77B"). That said Petition sets forth, among other things, the requisite jurisdictional facts, the nature of the business of Debtor, a brief description of the assets, liabilities and financial condition of the Debtor, and that Debtor did not have sufficient funds with which to meet and pay the obligations of Debtor set forth in said Petition and affected by the Plan of Reorganization, hereinafter mentioned. That attached to said Petition as Exhibit "E" was a Plan of Reorganization proposed by the said Debtor. That on January 28, 1938, an order of the Court was entered herein on said Petition, approving the said Petition as properly filed under Section 77B, continuing the Debtor in possession and control of its properties, pending a hearing on said Petition, providing for the time and place of said hearing and the parties to whom and the manner in which notice of hearing should be given, providing for the filing of claims and objections thereto and classifying the creditors of the Debtor whose interest would be affected by said Plan of Reorganization.

(5) That on February 28, 1938, said Petition came on for hearing pursuant to said Order of January 28, 1938, before this Court and the matter was continued to March 21st, 1938. The Court announced in open court on February 28, 1938, that in view of the heavy congestion of the Court's trial calendar, and that questions of fact too numerous, requiring too much time to be considered by the Court in sufficient detail were necessary to be heard and determined in order to enable this

Court to properly and equitably decide all issues which have been or may be raised herein, it would, therefore, appoint REUBEN G. HUNT as Special Master for the purpose of holding hearings as required by Section 77B. That the minute order appointing said Special Master is dated February 28, 1938. The formal written order of reference was signed on March 2, 1938 and filed herein on March 3rd, 1938, requiring all parties interested herein to submit to the said Special Master any and all answers, pleadings, objections and authorizing, empowering and directing the Special Master to hold hearings as required by the Act and by Order of Court and to submit to this Court his findings of fact, together with any recommendations which he might see fit to make.

(6) That on or about March 18th, 1938, pursuant to Order of Court, a modification of the Plan of Reorganization was proposed and filed herein by Debtor. That pursuant to Order of Court a copy of said modification of said Plan, together with a notice of a hearing thereon to be held on April 11, 1938, in the court room of the undersigned Judge of this Court was mailed on March 31, 1938 to the last known addresses of all known creditors and stockholders of Debtor. That said modification of said Plan does not adversely affect the rights of Debtor's Bondholders under said Plan; that none of said Bondholders withdrew their consent to said Plan; that Debtor's Class A Shareholders are adversely affected by said modification; that by the terms of said notice approved by this Court mailed to each of said Class A Shareholders it was provided that they could withdraw their consent to said Plan on or before April 11, 1938; that if their consent to said Plan was not withdrawn by said date they would be deemed to have consented to said modification; that

none of said Class A shareholders withdrew their consent; that Class A Shareholders holding 52,298.14 shares of said Class A stock, representing 82+% of all of said stock issued and outstanding filed with the Security-First National Bank of Los Angeles their written consent to said modification.

(7) That on or about April 9th, 1938, Reuben G. Hunt, Special Master, filed his report herein, showing, among other things, that hearings were held before him on March 3rd, 4th, 8th, 10th, 11th, 16th, 17th, 18th and on April 8th, 1938, on the said plan of reorganization, upon objections filed thereto and on matters set forth in the order of reference; that the following appearances were made before him:

Faries & McDowell by David R. Faries and J. Clifford Argue and Gibson, Dunn & Crutcher by J. C. Macfarland for the Debtor.

George R. Larwill and Frank S. Balthis, Jr. for Thomas A. Ogden, May Justice Johnson, Mary O. Rivers, Edwin M. and Maude M. Rankin, C. W. Olsen, Helen Avery Cameron, Emma L. Rooks, William Wildburger, Merritt W. Linscott and Anna Edge Linscott, bondholders holding Thirty-Three Thousand ($33,000.00) Dollars, principal amount of bonds.

Thomas K. Case in propria persona, bondholder, holding Thirteen Thousand Five Hundred ($13,500.00) Dollars, principal amount of bonds.

Clarke & Bowker by Robert M. Clarke and Earl E. Moss for Adele M. Cowan, bondholder holding Five Thousand ($5,000.00) Dollars, principal amount of bonds.

William Schoenau, Jr. in propria persona, bondholder, holding Twelve Thousand Five Hundred ($12,500.00) Dollars, principal amount of bonds.

Overton, Lyman & Plumb by C. L. McCaughey for Charlene Coulter and Mary E. Priest, bondholders holding Fourteen Thousand Five Hundred ($14,500.00) Dollars, principal amount of bonds.

That said Special Master's Report is hereby approved by this Court and the findings of fact contained therein are hereby adopted as the findings of this Court as fully as though set forth herein at length, except:

(a) In said Special Master's Report the recommendation is made that a permanent trustee should be appointed herein for the debtor corporation to act during the proceedings herein and in this connection this Court's conclusion and finding is at variance with that of the Special Master and the Court finds that it will be for the best interests of all parties in interest that the debtor continue in possession of all of its property, subject to the order of this Court during the pendency of this proceeding and that this is in accordance with the provisions of the Plan.

(b) The Special Master, at pages 23 and 46 of said report has erroneously described the provisions of the Plan with respect to the election of a board of directors of the new company, although at page 26 of his findings the Special Master has correctly set forth the provisions of the Plan which are that the board of directors of the New Company, upon its organization, shall consist of seven members, being six members of the present board of directors of the debtor and George R. Larwill, one of the attorneys representing certain intervening bondholders in this proceeding and such board shall hold office until their successors are elected at a meeting of the stockholders of the new company, which meeting shall be held within a period of ninety days from and after the date of the incorporation of the new company, or in the event

that such meeting cannot be held within such period, then within such further extension of time as may be provided by order of this Court and the new company shall take no part in the election of the board of directors, except that prior thereto it shall send out a formal notice thereof and a proxy in usual form, but without designation of a proxy holder, together with a letter urging all stockholders to be present in person, or to designate someone as their proxy and any and all persons who desire to be elected a director of the new company at such meeting shall solicit votes and proxies entirely at such person's own expense.

(c) Insofar as said findings in said Special Master's Report are otherwise inconsistent with the Plan and the findings of this Court as specifically set forth herein.

(8) That Debtor is a holding corporation, owning and holding all of the outstanding shares of the capital stock of the following corporations, excepting certain qualifying shares held by Directors of said corporation, the equitable ownership of which actually in the Debtor.

a. Los Angeles Shipbuilding and Drydock Corporation; a corporation organized and existing under the laws of the State of California.

b. Masset Timber Company, Ltd., a corporation organized and existing under the laws of the Province of Canada.

c. Puget Sound Lumber and Box Company, a corporation organized and existing under the laws of the State of Washington.

d. Pacific Wirebound Box Company, a corporation organized and existing under the laws of the State of California.

e. Western Marine Supply Company, a corporation organized and existing under the laws of the State of California.

f. Los Angeles Lumber Products Steamship Company, a corporation organized and existing under the laws of the State of California.

(9) That Los Angeles Shipbuilding and Drydock Corporation (hereinafter referred to as the "shipbuilding Company") is a corporation organized and existing under the laws of the State of California; that its principal place of business is and has been for more than six (6) months prior to January 28, 1938, in the City of Los Angeles, County of Los Angeles, State of California.

(10) That Debtor's principal asset consists of the ownership of all of the capital stock of said Shipbuilding Company; said Shipbuilding Company is engaged in the shipbuilding and ship repair work at Los Angeles Harbor, San Pedro, California and has substantial assets and earning possibilities, its fixed assets are subject to the lien of a Trust Indenture dated March 8, 1924 (Debtor's Exhibit "E" in evidence, as modified by supplemental indentures Debtor's Exhibits: "F", "G" and "H" in evidence) securing the payment of bonds upon which there is now owing a great deal more than the value of such assets. Said Shipbuilding Company has only current debts of small amount besides the lien of said bonds; that the current debts are not affected by the Plan but will be paid in the ordinary course of business. It has current assets not subject to the lien of said bonds which have a value of approximately $400,000.00. The value of said Shipbuilding Company's fixed assets is $430,000.00. The total value of all assets of said subsidiary is $830,000.00.

(11) That Debtor's subsidiaries Pacific Wirebound Box Company, Western Marine Supply Company and Los Angeles Lumber Products Steamship Company, have no tangible assets of any kind. That said companies have not operated since 1925. That they represent an annual expense to Debtor and have no value to the efficient operation of Debtor's business. That it is desirable that these companies be dissolved.

(12) That Debtor's subsidiary, Masset Timber Company, Ltd., owns twenty-four licenses issued by the Government of the Province of British Columbia, Canada, comprising approximately 12,000 acres of timber land on Graham's Island in British Columbia, Canada. That it owns in fee simple lots 1497, 1498 and 444, Queen Charlotte District, Province of British Columbia, whereupon *ar* located certain buildings, wharves and docks. That the Masset Timber Company, Ltd., has been a financial failure and a great expense to Debtor. That the property of said subsidiary company has no present market value.

(13) That Debtor's subsidiary, Puget Sound Lumber and Box Company, owns certain real estate, buildings, wharves and docks comprising the saw mill and box factory units located on Lake Union in Seattle, Washington. That said property has a water frontage of approximately 700 feet. That lumber operations at said plant have resulted in heavy losses. That said company has not operated since 1925. That the City of Seattle has extended its residential district to within short distances of the property and has zoned the property against a resumption of its former operations. That the saw mill building, originally erected at great cost, is specially constructed and unfit for other purposes. That the water

adjacent to the dock is of insufficient depth to permit commercial vessels of average draft to moor thereto for the discharging or unloading of cargo. That said docks and piers are in need of extensive repairs, necessitating the expenditure of sums in excess of their worth. That the property has value only as real estate and is worth not in excess of $40,000.00.

(14) That the estimated annual expense of maintaining the Debtor corporation and its subsidiaries in existence is Twenty-one Thousand Five Hundred ($21,500.00) Dollars. That the expenses of maintaining said corporations and their properties have been paid for many years from the earnings of the Shipbuilding Company.

(15) That in brief Debtor's assets, other than the stock of its subsidiary corporations consist of:

(a) Cash	$1,187.27
(b) Accounts Receivable, collectible	5,199.50
(c) Sinking Fund Account	3,070.80
(d) Leasehold interest in 68.54 acres of water frontage at Los Angeles Harbor, under lease from the Harbor Department of the City of Los Angeles, a Municipal Corporation, carried on the books of the corporation at a value of	1.00

This leasehold has no realizable value for creditors in the event of liquidation.

(16) That Debtor's liabilities consist of principal and interest amounting to some Three Million Eight Hundred Seven Thousand and Seventy-one and 88/100 ($3,807,071.88) Dollars upon first lien bonds issued March 8, 1924, secured by a mortgage or Trust Indenture which covers the fixed assets of the Shipbuilding Company and

the capital stock of the subsidiaries and upon which no interest has been paid since February 1st, 1929.

(17) That at the date of the institution of these proceedings under Section 77B, the Debtor was at all times and since has been unable to meet its debts as they mature.

(18) That Debtor is insolvent both in the equity sense, that is, it is unable to pay its debts in the ordinary course of business as they mature, and in the bankruptcy sense, that is, its assets at a fair valuation thereof based upon appraisal and audit reports introduced in evidence in this proceeding are insufficient to pay its debts.

(19) That Debtor's issued and outstanding capital stock consists of 57,065.65 shares of Class A and 5112 shares of Class B both of said classes of stock being of no par value. That Allen C. Stelle has filed a claim herein to the ownership of 722.35 of shares of Debtor's Class A stock which was heretofore cancelled on Debtor's books. This Court is reserving jurisdiction to hear and determine said claim and in the event said claim is approved, the outstanding class A stock of Debtor shall be increased to 57,788 shares. That there is no difference between said two classes of stock except that the Class A shares are entitled to a preference of $400,000.00 on liquidation together with interest thereon from April 1st, 1930 until paid, over the Class B shares, which amount shall be paid on account of Class A shares before any amount shall be paid on Class B shares.

(20) The present stockholders of Debtor, holding Class A shares, comprise some of those who are stockholders prior to the 1930 reorganization of Debtor or their successors in interest. The financial investment from the

beginning, of these stockholders, or their predecessors in interest, and the bondholders, has been approximately equal in the sum of Two Million Five Hundred Thousand ($2,500,000.00) Dollars for each class. At the time of the amendment of the Trust Indenture securing Debtor's Bonds referred to in Paragraph 23 hereof the assets then remaining were worth approximately Four Hundred Thousand ($400,000.00). If the bonds had been then foreclosed without such reorganization, said sum is about the maximum that the bondholders would have received. As a part of said reorganization the stockholders paid in Four Hundred Thousand ($400,000.00) Dollars in cash to permit the corporation to continue its business and in order to secure a release of stockholders liability.

(21) That the Class A shareholders have had the management and control of Debtor and have the right to its management and control until the maturity of said bonds in 1944 subject to the jurisdiction and control of this court in the above entitled proceeding.

(22) The bonds of Debtor are owned by approximately 757 individuals who are widely scattered and unorganized. It will be beneficial to the bondholders to allow the Class A shareholders to participate in this reorganization so as to provide continuity of management.

(23) That it will be an asset of value to the New Company and its shareholders to retain Debtor's present Class A shareholders as shareholders of the New Company because of their familiarity with the operation of the business of Debtor and its subsidiary Shipbuilding Company, and because of their financial standing and influence in the community.

(24) In April, 1930, a supplement to the Trust Indenture of March, 1924, was duly and regularly executed

in accordance with Section 11, Article 9 thereof. That said supplemental Trust Indenture was executed with the consent of 97% of the face value of all bonds outstanding and is binding upon all bondholders whether they consented to the execution of such supplemental Trust Indenture or not. That among other things by virtue of such Supplemental Trust Indenture interest on said bonds was reduced from 7½% to 6%, payable only out of earnings. The payment of interest was waived unless earned until 1944. That for all practical purposes said bonds cannot be foreclosed until they mature in 1944. That said supplemental Indenture and all provisions thereof, is effective and binding upon all holders of Debtor's bonds.

(25) That the principal valuable consideration passing between the bondholders and the stockholders to justify participation of stockholders in the Plan is the virtual abrogation of said agreement deferring foreclosure until 1944.

(26) That if the bondholders were able to foreclose now and liquidate Debtor's assets, they would receive substantially less than the present appraised value of Debtor's assets.

(27) That the bondholders cannot now foreclose, nor can they acquire the assets securing Debtor's bonds, or obtain control of Debtor without long and protracted litigation which would undoubtedly involve an appeal to the Supreme Court of the United States and would be expensive and of great injury to Debtor as a going concern.

(28) That bonding companies are unwilling to assume the risk of becoming surety for Debtor or its subsidiary

ship building company because of the outstanding bond issue. That without the ability to obtain surety bonds, bids cannot be made on the building of new ships and operations are restricted to small repairs.

(29) That the United States Government is planning the construction, for its navy, of many warships and auxillary vessels, the latter including mine sweepers, oil tankers, freighters, coast guard cutters and similar ships. That the shipyard of Debtor and its subsidiary shipbuilding company are equipped for and capable of building certain of said ships. That by reason of said shipbuilding program valuable opportunities are open to Debtor and its subsidiary shipbuilding company in the building of ships which will be lost to Debtor, its bondholders and other interested parties, if litigation is commenced and if the plan is not approved.

(30) That the value to the bondholders of maintaining Debtor as a going concern, and of avoiding litigation, is in excess of the value of the stock being issued to said Class A shareholders under said plan.

(31) That by said Order, entered January 28, 1938, this Court directed that there shall not be required to be filed herein as provided by Subdivision (e), Clause (1) of Section 77B a statement showing what, if any, claims and shares of stock have been purchased or transferred by those accepting the plan prior to the commencement of or in contemplation of these proceedings and the circumstances of such purchase or transfer as this Court is satisfied. That by reason of the number of securities of Debtor and the extent of the public dealing therein, the preparation of such a statement would be impractical.

(32) Pursuant to the petition of the Debtor filed herein on January 28, 1938, an order of this Court was made

and filed herein on January 28, 1938, determining the time, form and manner of filing and evidencing claims and interests, classifying creditors and stockholders of the Debtor into classes according to the nature of their respective claims and interests, fixing March 15, 1938, as the last day upon which claims against the Debtor must be filed, and ordering that the Debtor or any stockholder or creditor of the Debtor might object to the allowance as a whole or in part of any claim filed in this proceeding by filing an objection to the allowance of such claim with the Clerk of this Court on or before March 21, 1938, and providing that written notice of any such objection should be given to the claimant and to the Debtor by serving the same upon its counsel of record in this proceeding, and providing that the Debtor, the objecting party or the claimant might apply to this Court for a hearing upon any such objection, all as provided and ordered in said Order dated January 28, 1938. Said Order of January 28, 1938, provided that all claims in respect of which no objections shall have been filed or otherwise made in accordance with said Order would be deemed finally allowed, except as this Court should by order thereafter direct. The Court has caused reasonable notice of said Order to be given to creditors and stockholders by publication and by mailing a copy of said notice as provided in said Order to each known creditor and stockholder and each person affected by said Order. That at the hearing held on March 21, 1938, and subsequent hearings held pursuant to continuances ordered by this Court, opportunity was given to creditors and stockholders and all interested parties to be heard on the division of creditors and stockholders of Debtor into classes according to the nature of their respective claims and interests, made by this Court under its Order of

January 28, 1938; that the Court considered the objections filed thereto by Thomas K. Case and overruled the same, and that no other objections were made to said division.

(33) Pursuant to Order of this Court, entered herein on January 28, 1938, Debtor has filed herein such schedules and has submitted herein such other information as is necessary to disclose the conduct of the Debtor's and its subsidiaries' affairs and the fairness of the proposed Plan of Reorganization. That claims and evidences of interest have been filed herein on behalf of all bondholders by the Security-First National Bank of Los Angeles, as Trustee, and on behalf of stockholders by the Debtor as shown on the claims on file herein; that no objections have been filed or made to the allowance of any of said claims.

(34) That on February 13, 1937, application was made by Debtor to the Commissioner of Corporations of the State of California for authority to submit said Plan to its bondholders and stockholders. That a hearing was had on said application after notice to all creditors and stockholders and a finding was made that the terms and conditions of the proposed issuance of certificates of deposit are fair, and a permit was issued, dated June 14, 1937, by said Commissioner, authorizing the solicitation of bondholders for their approval of said Plan. That the Plan as originally filed herein was the same Plan so approved by the Corporation Commissioner of the State of California.

(35) That the Plan has been duly proposed by Debtor herein in accordance with the provisions of Section 77B, and no other Plan for the reorganization of the Debtor, or any amendment to said Plan or modification thereof,

except that mentioned in Paragraph 6 hereof, was proposed.

(36) That the only creditors and stockholders of Debtor affected by said Plan of Reorganization were and are as follows:

(a) Holders of Debtor's outstanding First Lien and Collateral Trust Twenty Year 7½% Sinking Fund Gold Bonds, hereinafter referred to as bonds, issued March 8th, 1924, of which Two Million Five Hundred and Sixty-five Thousand Five Hundred ($2,565,500.00) Dollars in principal amount remain outstanding and upon which no interest has been paid since February 1st, 1929.

(b) 57,065.65 shares of Class A stock, or in the event the claim of Allen C. Stelle is approved by the Court, 57,788 shares of said stock.

(c) 5,112 shares of Class B stock.

(37) That creditors of the Debtor, other than those herein designated, are not affected by said Plan of Reorganization and the Court has not required that such creditors file claims herein as the obligations of Debtor to such creditors have been and will be paid as they mature.

(38) That under the Plan and by Order of this Court entered January 28, 1938, for the purpose of the Plan and its acceptance, creditors and stockholders of the Debtor were divided into classes according to the nature of their respective claims and interests as follows:

Class I: The holders of Debtor's 7½% Sinking Fund Gold Bonds.

Class II: The holders of Debtor's Class A stock.

Class III: The holders of Debtor's Class B stock.

That pursuant to Order of this Court dated January 28, 1938, reasonable notice was given of such division of creditors into classes for the purposes of the plan, as hereinbefore in Paragraph (30) set forth.

(39) That acceptances in writing in form as heretofore and hereby approved by this Court have been filed with the Security-First National Bank of Los Angeles, as Trustee, and in these proceedings by or on behalf of creditors and stockholders whose claims have been allowed and as classified, showing that the Plan has been duly accepted as follows:

Class I: By holders of Two Million Three Hundred and Three Thousand ($2,303,000.00) Dollars principal amount of Debtor's bonds, specified under Class I above, said amount is 89+% of the principal amount of all outstanding of Debtor's bonds.

Class II: By holders of 56,920.180 shares of Debtor's Class A stock, representing ninety-eight plus percent of all of said outstanding Class A stock.

Class III: By holders of Four Thousand Five Hundred and Ninety-nine shares of Class B stock of Debtor, representing eighty-nine plus per cent of all outstanding Class B shares.

(40) Notice as required to be given of hearings by the Orders duly made and entered herein on January 28, 1938, and March 21, 1938, have been given in compliance with said Orders, and all creditors and stockholders of Debtor, all parties to this proceeding and all interested parties herein had due notice and an opportunity to be heard with respect to the confirmation of the Plan, and to make objections to the Plan and its confirmation, and Debtor has moved for the confirmation of the Plan. The

COURT IS SATISFIED AND FINDS THAT:

(a) All proceedings taken by Debtor and its Board of Directors in the preparation and submission of said Plan and for its approval and confirmation have been taken in good faith;

(b) The plan is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders of the Debtor and is feasible;

(c) The Plan complies with the provisions of Subdivision (b) of Section 77B, and all other applicable provisions of Section 77B;

(d) The Plan has been accepted as required by the provisions of Subdivisions (e), Clause (1) of Section 77B and all other applicable provisions of Section 77B;

(e) The provisions of Subdivision (e), Clause (2) of Section 77B are not applicable for the reason that Debtor is not a utility subject to the jurisdiction of a regulatory Commission or Commissions or other regulatory authorities of the State of California in which the properties of the Debtor are operated;

(f) All amounts to be paid by the Debtor for services or expenses incident to the reorganization are to be subject to the approval of this Court;

(g) The offer of the Plan and its acceptance are in good faith and have not been made or secured by any means or promises forbidden by the Bankruptcy Act;

(h) The New Company that will issue securities and acquire property under the Plan will be such as will be authorized by its charter or by applicable State or Federal Laws, upon the final confirmation of the Plan, to take all action necessary to carry out the Plan.

(i) That Debtor has no executory contract or unexpired lease of real estate which is to be rejected under the Plan.

(41) The officers of Debtor are paid no salaries; that the principal officers of the subsidiary ship building company are C. C. Spicer, President, whose salary is $1000.00 per month; J. B. Ingoldsby, whose salary is $400.00 per month, and George B. Southerland whose salary is $600.00 per month. That all of said officers are capable and experienced men and that the salaries paid them are reasonable. That it is for the best interests of Debtor and all parties affected by the Plan, that the order allowing Debtor to remain in possession of its business and assets be made permanent.

(42) That notices of the hearing for the purpose of determining whether Debtor should remain in possession of its property and assets and for a consideration of and confirmation of the Plan were duly given in the manner provided by Order of this Court, entered on January 28, 1938, and that the Debtor and all creditors and stockholders of the Debtor and all other interested parties have had full opportunity to be heard on the proposed confirmation of the Plan, to make objections to the Plan and to be heard upon all of the matters specified in the notice of such hearing. That evidence sufficient and satisfactory to this Court has been presented with respect to the assets and liabilities of the Debtor and of its subsidiaries and with respect to various matters and factors involved in connection with the formulation of the Plan and with respect to the Plan and all other matters determined or adjudicated by this Order.

(43) That this Court has exclusive jurisdiction of the Debtor and of its subsidiaries and of the property of the Debtor and of the property of its subsidiaries, wherever located for the purpose of these proceedings under Section 77B and has jurisdiction to make the findings, orders, adjudications and decrees contained in this Order.

(44) That due and reasonable notice of all hearings had herein has been given as required in said Section 77B and by the Order of this Court.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED AS FOLLOWS:

(1) The Court makes this order as an interloctory order confirming the Plan at this time due to and in accordance with the provision contained in subdivision (7) of paragraph (f) of Section 77B of the Bankruptcy Act, which reads as follows "(7) the debtor, and every other corporation, issuing securities or acquiring property under the plan, is authorized by its charter or by applicable State or Federal Laws, upon confirmation of the plan, to take all action necessary to carry out the plan, and that, in case the debtor is a utility corporation subject to the jurisdiction of a regulatory commission or commissions or other regulatory authority or authorities, created by the laws of the State or States in which the properties of the debtor are operated, all authorizations, approvals, or consents of each such commission or authority required by the laws of such State or States, have been obtained."

The Plan is hereby confirmed subject to the requirement that the Debtor and its Board of Directors shall and are hereby ordered, in the manner provided by law, to create or cause to be created a New Company as provided in the

Plan, which New Company shall take all steps in the manner provided by law to authorize the issuance of new securities described in the Plan and the New Company shall make application to and obtain a permit from the Commissioner of Corporations of the State of California to issue the new securities under the Plan; that proof satisfactory shall be presented to this Court to the effect that said New Company has been duly created and is authorized by its charter or by applicable State or Federal laws, upon confirmation of the plan, to take all action necessary to carry out the Plan and that said securities have been duly authorized and that said permit has been granted by said Commissioner to said New Company, all in accordance with the Plan and in the manner provided by law, and thereupon this Court will make and enter its order of final confirmation of the Plan.

(2) The provisions of the Plan and this Order shall be binding upon the Debtor and stockholders of the Debtor and all creditors of the Debtor, secured or unsecured, whether or not affected by the Plan, and whether or not their claims have been filed, and if filed, whether or not approved and allowed, including the stockholders and creditors who have not, as well as those who have accepted the Plan.

(3) Until this Court shall provide otherwise the Debtor shall continue to have all of the title and shall exercise subject to the control of this Court all of the powers vested in such Debtor by statute and by Orders of this Court previously entered herein. The Debtor shall upon the further order of this Court file with this Court a "Debtor in Possession Bond" in such penal sum as this Court may direct, conditioned upon the faithful perform-

ance of its duties herein. The form of said bond to be first submitted to Reuben G. Hunt, Special Master, for his approval and thereafter to be subject to the approval of this Court.

(4) Until further order of this Court debtor shall pay no salaries to its officers; debtor subsidiary Shipbuilding Company shall and it is hereby authorized and directed to pay to its officers mentioned in paragraph 41 hereof, the salaries therein set forth.

(5) The Debtor shall pay to and/or for the account of the New Company all actual expenses in connection with the carrying out of the Plan as follows: Filing fees and other charges of the Secretary of State of the State of California and recording fees of the County Clerk of the County of Los Angeles where the Articles of Incorporation of the New Company are to be filed; all printing and other incidental expenses in connection with the creation of the New Company and the authorization of the issuance of the new securities, the filing fees and any other expenses in connection with the obtaining of the necessary permits from the Commissioner of Corporations of the State of California, and printing of the new securities.

(6) All the claims filed herein are finally allowed, except claims for taxes, which, if allowed, will be paid in full in cash under the Plan, and the claim filed by Allen C. Stelle to certain shares of the Class A stock of this corporation, which, if allowed, or disallowed, will not materially and adversely affect the interest of any creditor or stockholder.

(7) All objections to the Plan of reorganization and objections to the order of this court classifying creditors and stockholders of the Debtor into classes according to the nature of their respective claims and interests, and objections to the jurisdiction of this court filed by Thomas K. Case and other objecting bondholders and their exceptions to the Special Master's report, are hereby overruled.

(8) The Court specifically reserves jurisdiction:

(a) To make further orders in connection with and to supervise and control the putting into effect and the carrying out of the Plan and final confirmation thereof, including the giving of such directions, authorization or approval as the Court may determine in regard to the New Company; the making or joining in by the proper parties of an instrument or instruments of transfer and conveyance; the incorporation of the New Company referred to in the Plan, the authorization, creation and issuance of the new securities described in the Plan and the delivery of said new securities in exchange and payment for the proper assets of the Debtor in accordance with the Plan and the delivery of the new securities called for by the Plan to the creditors of the Debtor; to consider and pass upon the form, execution and delivery and sufficiency of all documents to be executed in connection with the consummation of the Plan, and taking of all other proceedings or action and the giving of all directions to the Debtor, the New Company and all other interested parties or persons which may be necessary or proper in order to

consummate the Plan and effectuate its substance and intent.

(b) To fix and direct the payment of administrative expenses and allowances and to allow reasonable compensation for the services rendered and reimburse for the actual and necessary expenses incurred under or in connection with these proceedings and in connection with the Plan by officers, parties in interest, trustees, depositaries and the attorneys or agents of any of the foregoing or of the creditors and of the Debtor.

(c) To make such provision as may be equitable by way of injunction or otherwise, to discharge the Debtor from its debts and liabilities and to end all rights and interests of stockholders, creditors or claimants, except as provided in the Plan or as may consistently with the provisions of the Plan be reserved under the order or orders directing the transfer and conveyance of the estate, property and assets of the Debtor to the New Company.

(d) To determine and pass upon the claims filed by Allen C. Stelle and all tax claims now on file or which may hereafter be filed hereunder and to hold hearings on Debtor's petition for tax bar order and to make such order or orders as it deems necessary or proper in connection therewith.

(e) To enter a final decree closing the case.

(f) Generally determine any and all matters pertaining to this Order or to the plan not determined heretofore or by this order.

(9) The Court hereby directs that the Debtor report to this Court in the Court room of the Honorable R. E. Jenney, United States District Judge in the Pacific Elec-

tric Building at the corner of 6th and Main Streets, Los Angeles, California, on May 31st, 1938, at 2 o'clock P. M. of said day, or as soon thereafter as counsel may be heard, its compliance with this order, at which time this Court will pass upon such matters in this proceeding as may be presented to it or as to which the Court has reserved jurisdiction by this or any prior order herein.

Service of a copy of this Order on or before May 18th, 1938, upon the attorneys for all parties who have appeared in this proceeding and publication of a notice thereof in substantially the form attached hereto, in the Los Angeles Daily Journal on the 18th day of May, 1938, is hereby ordered and determined to be reasonable and sufficient notice of said hearing to be held on May 31st, 1938, and said hearing may be adjourned without further notice, except by announcement at said hearing, unless the Court shall otherwise direct.

DATED: May 12th, 1938.

RALPH E. JENNEY
United States District Judge.

APPROVED AS TO FORM.

GEORGE R. LARWILL and FRANK S. BALTHIS, JR.
by Frank S. Balthis, Jr
THOMAS K. CASE
REUBEN G. HUNT
Special Master

[Endorsed]: Filed May 12, 1938 at 25 min. past 3 o'clock P. M. R. S. Zimmerman, Clerk M. J. Sommer, Deputy.

[TITLE OF DISTRICT COURT AND CAUSE.]

REPORTER'S TRANSCRIPT OF OPINION OF THE COURT PURSUANT TO:

1. Further hearing on plan of reorganization and proposed changes and modifications thereof, pursuant to order filed 3/21/38;

2. Further hearing and confirmation of report of special master filed 4/8/38, and hearing exceptions to same.

Appearances:

J. C. McFarland Esq.,
D. R. Faries Esq., and
J. C. Argue Esq.,
for debtor.

Frank S. Balthis Jr., Esq.
for Mae Justice Johnson et al:

Wm. Schoenau Jr., Esq
in propria persona,

Thomas K. Case Esq.,
in propria persona.

Robert M. Clark Esq.,
for bondholders Cowan et al:

Overton, Lyman & Plumb
by C. L. McCaughey Esq.
for bondholder Charlene Coulter

LOS ANGELES, CALIFORNIA,

FRIDAY, APRIL 22nd, 1938, 2 P. M.

THE COURT: It would probably be desirable if the opinion of the Court in this matter might be reduced to

writing, or that at least a memorandum opinion might be filed. Unfortunately the pressure of work in this court is so great that to take the time to write a formal opinion in this matter, as important as it seems to the Court, is impossible. The Court will then simply make an oral opinion, which will be a more or less running comment upon the entire situation.

May I say before I start that if all matters before this Court, or any other court, were presented with the same diligence and courtesy and careful attention to the problems involved, the burden of responsibility on this court would be very much lessened. The contacts that this court has had with counsel on all sides in this matter have been a matter of constant pleasure, and I happened to run into the Master on the street a couple of days ago and he made the same observation. After all, the Master was appointed as an arm of this court, to take testimony and to make certain recommendations. My remarks will be predicated upon the thought that you have all carefully read the Master's report. If you have not done so I commend it to your attention. I think that it deserves careful attention as covering in detail many of the points which manifestly this court would not be able to touch upon.

There are here a considerable number of rather interesting legal problems which have been presented orally and by briefs to the court. Most of the burden of the opposition has fallen upon Mr. Case, and I shall usually refer to him in connection with the objectors and respondents to the proposed Amended Plan of Reorganization. I shall not bother to use the term "Amended Plan of Reorganization" because I will undoubtedly drop out the word "Amended" unconsciously many times. After all, the

Plan as finally amended, after the hearing before the Master, is the plan before the court. It must be understood that this plan, as originally proposed, after many conferences among all parties interested, was finally amended so that the objection of a substantial number of bondholders was withdrawn, and bonds have been deposited since the amended plan.

The first question that seems to the court should be considered is the question of the constitutionality of Section 77-B of the Bankruptcy Act, which has been questioned by counsel for the objectors. The constitutionality of Section 77-B of the Bankruptcy Act has never been passed upon directly by the Supreme Court of the United States. It has held Section 77 itself constitutional, relating to railroad reorganizations, which are in many respects similar to the intendments of Section 77-B. I might cite for your consideration:

> Continental Ill. National Bank & Trust Co. v. Chicago R. I. & P. Ry. Co., 294 U. S. 648, 27 ABR NS 715, 79 L. Ed. 1110.

The Circuit Courts of *Appeal* of the Second, Fourth, Seventh and Eighth Circuits have all held Section 77-B to be constitutional. The Second Circuit case is In re New Rochelle Coal and Lumber Co. CCA 2, 29 ABR NS 177, 77 Fed. (2d) 881.

I think, for the sake of brevity, I shall simply refer to one citation. If you wish any more you may get them from the court reporter. I will furnish him with the citations.

In the Fourth Circuit, Campbell v. Allegheny Corp., 27 ABR NS 504, 75 Fed. (2d) 947;

In the Seventh Circuit, In re Georgian Hotel Corp., 31 ABR NS 234, 82 Fed. (2d) 917; and

In the Eighth Circuit, Grand Boulevard Investment Co. v. Strauss, 29 ABR NS 188, 78, Fed. (2d) 180.

No Circuit Court of Appeals or District Court, so far as there is a reported case, and no state court, so far as there is a reported case, has held the Section as a whole unconstitutional.

The so-called Tennessee Publishing Co. case has had a great deal of consideration by counsel for the objectors. It seems to this court to be distinguishable in principle. That case appears in 81 Fed. (2d) 463. A careful analysis of that Tennessee case indicates that the lower court found the proceeding instituted in good faith but declared subsection (b)(5) of Section 77-B, insofar as it purports to permit adjustment of liens, without the consent of the lien holders, constitutionally invalid under the Fifth Amendment to the Constitution. That case was appealed, and the Circuit Court found that the Plan of Reorganization which was presented to the District Court, and which, of course, was a part of the record on appeal, was hopelessly unworkable. The court said that it was apparent from the record that the company had had operating losses for such a length of time that it seemed impossible, under the plan presented, to turn those deficits into profits; that there was no reasonable prospect for the rehabilitation of the debtor. The appellate court, therefore, held that the plan was not filed in good faith, and was not a feasible one. The Circuit Court admitted that because of the finding of lack of good faith the question of the constitutionality of subsection (b)(5) was perhaps not open to assault, but it did go on to say that because of the

fact that other plans of reorganization might be presented, they would determine the constitutional question presently instead of at some later date. They upheld the decision of the lower court, finding the provision unconstitutional, stating that under the Fifth Amendment to the Constitution, the lien holders had the right, under their contract, to retain their lien, to public sale, to have the mortgaged property devoted to the satisfaction of the debt, etc. That is just a mere sketch of the opinion.

The decision of the Circuit Court was affirmed by the Supreme Court in 299 U. S. 18. However, the Supreme Court affirmed the decision on the ground that the plan was not presented in good faith, and feasible, and declined to pass upon the constitutional question.

So, in the opinion of this court, Section 77-B of the Bankruptcy Act is constitutional. The question is whether or not the law authorizes the court to adjust the debts and obligations of an embarrassed corporate debtor, unable to pay its debts as they mature, without making a formal adjudication of bankruptcy or taking possession of its property for distribution among creditors, and whether that power may be sustained under the power over bankruptcies vested in Congress. The grant of power to Congress to establish uniform laws on the subject of bankruptcies does not seem to be limited to the forms in which that power has heretofore been exercized by Congress, or by the laws relating to bankruptcies which have been passed in this country or in England or even in the several American Colonies prior to the adoption of the Constitution. The court refers those who may be interested to articles appearing in:

12 New York Univ. Quarterly Review 198.

21 American Bar Association Journal 47.

All phases of the relationship between a debtor financially embarrassed and his creditors, are brought under the control of Congress by the Constitutional grant of power, and the fact that a particular mode has hereto been employed in dealing with this relationship should not, it seems to this court, be taken as a measure of the court's power over it or to the power of Congress to enact legislation in that regard. Reference is made:

Hanover National Bank v. Mayses, 186 U. S. 181;
Sturgis v. Crowninshield, 4 Wheat. 122;
In re Lanquist, 70 Fed. (2d) 929;
Nelson v. Carland, 1 How. 265;
In re Reiman, 7 Ben. 455.

The Supreme Court, in the Rock Island case, to which I made reference previously, after exhaustively considering the constitutionality of Section 77, which it upheld, summed up the situation rather pertinently, as follows:

"It follows from what has now been said, that Section 77, in its general scope and aim, is within the power conferred by the bankruptcy clause of the constitution; and we so hold."

In view of the statements contained in the opinion of that court in the case of Louisville Joint Stock Bank v. Radford, 295 U. S. 555, with which, of course, you are all familiar, respecting the power of the majority of a class to bind a minority in composition matters, it seems to this court likely that the Supreme Court of the United States would hold Section 77-B constitutional, if the question were squarely presented to it. In the absence of any such definite decision on the part of that court, of course, it becomes the obligation of this court to do the best it

can under the circumstances. That court would, we believe, hold that a lien, otherwise valid under Section 77-d of the Act, could be impaired where the lien holder is a member of a class and the requisite two-thirds in amount of that class consent, and the plan of impairment is found by the court to be fair, equitable, feasible and not discriminatory. In that connection I will cite:

In re Central Funding Co., CCA 2, 75 Fed. (2d) 256, 27 ABR NS 764;

Downtown Inv. Assoc. v. Boston Met. Bldg., in the First Circuit, which is a later case, 81 Fed. (2d) 314; also, although not quite so directly in point;

Canada Sou Ry. v. Gebhard, 109 U. S. 527.

In the case of Campbell v. Allegheny Corporation, which we referred to a few moments ago, Judge Parker of the Fourth Circuit, said in substance:

"It is no ground of constitutional objection to the Corporate Reorganization Amendment (which, of course, is Section 77-B), that the Act relates only to corporate debtors as the uniformity required by the Constitution is geographical and not personal."

"Section 77-B of the Bankruptcy Act authorizing a court to readjust the debts and obligations of an embarrassed corporate debtor, without making formal adjudication of bankruptcy or taking possession of his property for distribution among creditors is within the power over bankruptcies vested in Congress by the Constitution."

"Section 77-B of the Bankruptcy requiring secured creditors of a corporation to scale their debts in accordance with the plan which two-thirds of them are willing to accept and which has been approved by the court as

reasonable and fair, and accept in lieu of payment in money such securities as are specified in the plan, is not such an arbitrary and unreasonable exercise of the bankruptcy power as to amount to a denial of due process."

"The fact that secured debts are affected by the Corporate Reorganization Amendment to the Bankruptcy Act does not affect its constitutionality."

"There is nothing in the Corporate Reorganization Amendment relating to stockholders that affects its constitutionality."

"Like other constitutional grants of power, that giving Congress power over bankruptcies is to be interpretated, not in the light of the conditions with which the framers of the Constitution were familiar, but of what is required under modern conditions to deal adequately with the relationship existing between embarrassed debtors and their creditors."

The acceptance of a proposed plan by a large percentage of the parties interested is, it seems to the court, strong evidence that it is fair and feasible, and that it is made in good faith. While a court of equity will not allow minority bondholders to be disregarded or unfairly treated in a reorganization plan, yet, on the other hand, it will not lend its aid to a scheme or to schemes by minority bondholders opposing a fair reorganization plan solely as a means for obtaining greater value or more favorable terms for their bonds than are to be given by the plan to the great majority of the bondholders. Citing:

Palmer v. Bankers' Trust Co., CCA 8, 12 Fed. (2d) 747, 754.

Downtown Inv. Assoc. v. Boston Met. Bldg., CCA 1, 81 Fed. (2d) 314.

In the latter case Judge Morris summed the situation up this way:

"Some of the tests applied by the Supreme Court in dealing with the question of whether a plan of reorganization is fair and equitable in equity receivership proceedings are that the plan must not exclude any creditor from participation under the penalty of the plan being declared a fraudulent conveyance and that it must not disregard the priority of any class of creditors. In the case of Kansas City Terminal Railway Co. v. Central Union Trust Company, 271 U. S. 445, 454, 46 S. Ct. 549, 551, 70 L. Ed. 1028, it was said with reference to a plan of reorganization:

" 'But "no such proceedings can be rightfully carried to consummation which recognize and preserve any interest in the stockholders, without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation. In other words, if the bondholder wishes to foreclose and exclude inferior lien holders, or general unsecured creditors and stockholders, he may do so; but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and preserve the prior rights of general creditors thereof. This is based upon the familiar rule that the stockholders' interest in the property is subordinate to the rights of creditors, first, of secured and then of unsecured creditors. And any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation" Louisville Trust Co. v. Louisville Railway Co., 174 U. S. (674), 683, 684, 19 S. Ct. (827) 830 (43 L. Ed. 1130).'

"From this it would seem that no plan is fair and equitable that does not recognize the prior rights of creditors. See, also, First National Bank v. Flershem, 290 U. S. 504, 54 S. Ct. 298, 78 L. Ed. 465, 90 A. L. R. 391.

"One of the impelling reasons for the passage of 77-B by the Congress was to provide a simpler method for the reorganization of corporations laboring under financial embarrassment due to overcapitalization and excessive fixed charges resulting from easy credit and excessive expansion of more prosperous days. It was necessary to devise a law to prevent unreasonable minorities from blocking fair and equitable plans of reorganization which they could do prior to the passage of 77-B."

And I think within the experience of all of us here we know that one or two recalcitrant bondholders have been able, under the old method, to hold up very definitely beneficial plans until they were paid off 100 cents on the dollar. Continuing, Judge Manton said:

"In order to accomplish the desired purpose Congress turned to the principles of the Bankruptcy Act passed in 1898. This had stood the test of constitutionality. And as we view it, 77-B is but an extension of the doctrine of composition provided in Section 12 of the original Bankruptcy Act.

"Reorganization plans under 77-B may differ from offers and compositions in form and complexity, but the difference is little more than one of degree. A plan of reorganization when accepted is nothing more than an agreement between the debtor and its creditors and stockholders, or if the debtor has been declared insolvent, then between the several classes of creditors. When such contract or agreement has been accepted by the requisite

majority of creditors and stockholders, the principle long recognized in composition cases steps in and under the supervision of the court imposes upon objecting minorities the will of the majority. This could not be accomplished under the acid tests applied to equity receiverships before the passage of 77-B.

"We therefore hold that Section 77-B does not require that every plan approved as fair and equitable shall be of such a character that it would withstand attack by non-assenting creditors asserting their strict legal rights unaffected by any principles of the Bankruptcy Act.

"To hold that the phrase 'fair and equitable' has the same meaning when applied to a reorganization under 77-B as it had in equity receiverships, is to eliminate from it to a certain degree the rights of creditors and stockholders to adjust their respective rights by contract and nullify provisions of the Act which was passed to facilitate corporate reorganizations."

Much confusion in this regard might be obviated by giving careful consideration to the opinion in the case of In re 333 North Michigan Avenue Building Corp. CCA 7, 31 ABR NS 639, reported in 84 Fed. (2d) 936. In that case Judge Sparks said:

"When a class consists of only one party, regardless of the nature of his claim, his consent must be obtained, provided his claim is affected by the plan. If, however, he is one of a class, and two-thirds of that class approve a plan which the court finds fair, equitable, feasible and not unfairly discriminatory in favor of any class, and all classes have so consented, the remaining members of that class or classes will be bound by the plan although their rights may be changed. (To the same effect) Conti-

nental Illinois Nat. Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co., 294 U. S. 648, 27 Am. B. R. (N. S.) 715, 55 S. Ct. 595, 79 L. Ed. 1110; Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 28 Am. B. R. (N. S.) 397, 55 S. Ct. 854, 79 L. Ed. 1593, 97 A. L. R. 1106; Cumberland Glass Manufacturing Co. v. De Witt, 237 U. S. 447, 34 Am. B. R. 723, 35 S. Ct. 636, 59 L. Ed. 1042." We have been unable to find any expression of the Supreme Court which is at variance with this interpretation, and it seems to be so indicated also in the case of

In re Georgian Hotel Corporation, CCA 7, 31 ABR NS 234, 82 Fed. (2d) 917.

In that case the court made the following statement, which, of course, must be interpreted in the light of the facts as they appear there:

"As to allotment of 30 per cent of the stock to the subordinate creditors, we believe that this is fairly within the judicial discretion of the District Court. While it is not likely that at the present time the subordinate creditors would have realized anything if the first mortgage had been foreclosed, those creditors would, for three months after one year following the foreclosure sale, have had a right of redemption—a right which might have been valuable. And there is the possibility that, with a substantial 'come-back' in affairs, property values may increase sufficiently to give the debtor a substantial equity in the property of which these creditors would have the benefit. Such possibilities would tend to support the court's discretion in making some allowance to these creditors in a proceeding under which there is to be effected a

present adjustment of all the claims against the debtor, of whatever rank or class."

I, possibly, have gone more fully than necessary into the constitutional phases of this matter, but counsel has presented the matter on behalf of himself and the other objectors so carefully that it seemed to the court advisable to indicate clearly the line of demarcation in thinking between counsel for the objectors and the court. It might be well, inasmuch as I believe the position of all the objecting bondholders is as indicated by Mr. Case, that I take up the various points.

The first point, possibly not in chronological order, is that by the modified Plan the bondholders would be deprived of their substantial rights, among which are: The right to foreclose their mortgage, to have a judicial sale of the pledged assets under the direction of the court, to bid at the sale on the properties pledged in the trust deed, to have the rents and profits in the meantime, and also that the bondholders would lose their right to realize on a deficiency claim from the present stockholders.

I will now consider briefly the last phase, in order to dispose of it; that is, as to stockholders' liability. Even if there were a judicial sale under foreclosure and a deficiency judgment, the bondholders would not thereby have any claim against stockholders which could be enforced in this proceeding. After all, in that regard, it seems to the court that we would still be subject to Section 4 of the Bankruptcy Act, which would not give this court power to determine the issues on stockholders' liability which does not pass to the trustee in bankruptcy. Practically all of the bondholders some time ago waived this liability. The objectors and non-assenting bondholders, who appar-

ently hold less than some fifty-odd thousand dollars in bonds, might have had the right to sue the old stockholders upon such stockholders' liability. However, Article IX, Section 11, page 79 of the Trust Indenture and proceedings which have been heretofore taken thereunder seem to indicate that stockholders' liability was waived on behalf of all bondholders against many of the old stockholders. Mr. Case insists that this waiver is invalid as to him because he did not expressly consent thereto, although the owners of three-fourths and over in amount of all outstanding bonds did so consent, and consented strictly in accordance with the terms of the trust indenture, evidently. The court believes that the provision in the trust indenture is binding. The matter will be discussed somewhat more fully at a later time, and will not be given further consideration here as it will interfere with the consideration of the other points wherein the objectors and respondents feel substantial rights have been interfered with.

If there were only one lien holder, or bondholder, the position of the opponents to the plan that the secured debt could not be scaled down without the consent of that one bondholder would be supported by authority, viz., Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555; Security-First National Bank of Los Angeles v. Rindge Land Company, 85 Fed. (2d) 557; Horn v. Ross Island Sand and Gravel Company, 88 Fed. (2d) 64, which has been discussed at length in the argument, to which the court will give some further consideration later. I also refer to the case of Tennessee Publishing Co. v. American National Bank, 81 Fed. (2d) 463.

But, as pointed out in the Radford case, a different principle applies where there is a class of lien holders as

we have in the case at bar, and where Mr. Case and his associates are only two of many lien holders of the same class. In such a situation there may be a scaling down of the secured debt, either by way of reduction of interest and reduction of principal, or extension of maturity date, provided two-thirds of the class consent, and provided further that the plan is fair, equitable, feasible and not discriminatory as to any member of the particular class.

The court feels that the Horn case, by our Ninth Circuit, is authority for that statement. The decision is, perhaps, somewhat unfortunate in that the facts are not very clearly indicated in the opinion. Suffice it to say, however, that in that case the court indicates clearly that there was no consideration passing from the stockholders to the enterprise, which would have made the proposition a proper one under the law. The 333 North Michigan Avenue Building Company case and the Downtown Investment Association case, which I have cited heretofore, are both authority for that general statement of the court.

The second point of the objectors is that no stock in the reorganized corporation can be given stockholders upon any basis since the debtor corporation is insolvent.

As is quite frequently the case, where we have a new law on the statute books, the courts possibly are not as careful in their statements as experience later leads them to be. There is an expression, for instance, in a number of cases that secured creditors must be made whole. Well, I don't know just what "whole" means. Does it mean payment of their principal and accrued and unpaid interest in full, in cash immediately on the line, or does it mean something less than that?

MR. CASE: "Completely compensatory" is another expression.

THE COURT: That, probably is more nearly a correct indication, and it is a terminology which has been subsequently used by many courts, as indicated by Mr. Case.

It does not seem to this court that it necessarily follows that stockholders cannot be given any consideration where the debtor corporation is insolvent. It is true, as suggested by counsel quite pertinently, that creditor lien holders must be fairly compensated before old stockholders should properly be let into the picture; and the Rindge case is a very good authority on that point. However, the court does have wide discretion in determining whether or not there has been such fair compensation provided under the plan as indicated in the Georgian Hotel case.

In the reorganization of weak enterprises, where it is desirable to to clear away all bonded indebtedness so as to facilitate the raising of new capital, shares of stock certainly may be issued for all outstanding bonds and it has been done many times. In such cases it is usual to wipe out the interests of the old stockholders, or to scale down their holdings very drastically, or even to compel them to pay a heavy assessment in order to retain any interest in the project. That statement is confirmed by:

Gerdes on Corp. Reorganizations, p. 1643, Sec. 1026.

Ginty v. Ocean Shore Ry. Co., 172 Cal. 31, 45.

While a fair plan must give due recognition to the interests of all classes of creditors and stockholders, this

does not mean that recognition may only be given by cash payment in part or in full. Citing:

Gerdes on Corp. Reorganization, p. 1741, Sec. 1086.

In the case of In re New York Railways Corp., 82 Fed (2) 739, 30 A. B. R. (N. S.) 748, Judge Manton, in the Second Circuit, used some of that language to which I referred a short time ago:

"The courts will scrutinize with care all plans of reorganization proposed for insolvent companies to make certain that assets belonging to creditors are not by indirection being diverted to stockholders, but it is obvious here that no such purpose is shown. Stock equity may not be allowed to participate in any plan of reorganization which does not first provide for making creditors whole."

It may be that the distinguished justice meant properly or fairly compensated by his use of the word "whole". That was in the Boyd case, with which you are all familiar.

As pointed out by the Supreme Court in the case of Kansas City Terminal Ry. Co. v. Central Union Tr. Co., 271 U. S. 445, in discussing the effect of the Boyd case,

"This does not require the impossible and make it necessary always to pay unsecured creditors in cash before stockholders may retain any interest whatever in the reorganized company. By way of illustration it further pointed out that such creditors can be protected 'by the issuance, on equitable terms, of income bonds or preferred stock.' And we now add that, when necessary,

they may be protected through other arrangements which distinctly recognize their equitable right to be preferred to stockholders against the full value of all property belonging to the debtor corporation, and afford each of them a fair opportunity, measured by the existing circumstances, to avail himself of this right."

The bankruptcy court, of course, must scrutinize reorganization plans which are proposed for insolvent companies in order to be sure that assets belonging to creditors are not by indirection diverted to stockholders (and in that same connection we might cite the Day & Meyer case, in the Second Circuit, which is a very late case, appearing in 93 Fed. (2d), 657) or to the debtor corporation itself (as indicated in the Horn case in this Circuit), but it seems to this court that this means that old stockholders cannot be provided for in the reorganization where they furnish the creditors compensating advantages.

In the case of In re Day & Meyer, to which I just alluded, and which is one of the latest cases on the subject, it appeared that there was a substantial equity in the property over the bonded indebtedness, but the plan provided that the bonds be reduced to one-half their principal amount and past due interest thereon eliminated, and that the equity created by such scaling down was to be represented by the issuance of new preferred and common stock to be shared by bondholders with general creditors, old stockholders and existing management. The appellate court disapproved this plan because it did not preserve priorities and deprived bondholders of their lien without any compensating advantages.

In the case of Horn v. Ross Island Sand & Gravel Co., by this Circuit, to which we have just alluded, it appeared

that the bonded indebtedness covered five parcels of property, three of which were land, the fourth buildings and equipment upon the land, and the fifth shares of stock in two corporations. It also appeared that the shares of stock of one of the corporations were turned into cash during the proceeding. The Plan of Reorganization provided for the distribution among the bondholders on a pro rata basis of the cash thus realized from the sale of stock, but that all the other items of property were to be turned back to this debtor, free of the bond lien. While the plan was actually approved by the requisite majorities of bondholders, unsecured creditors and stockholders, the court held, and it seems to this court correctly and with propriety, that there were no compensating advantages furnished by the debtor to the bondholders. The court expressly found that there was no consideration passing. It did not even say that it was not adequate. The appellate court rejected the plan, calling attention to its decision in the case of the Security-First National Bank of Los Angeles v. Rindge, which I have alluded to before, and in that case the court said:

"There is nothing in Section 77-B which authorizes a debtor to pay a secured creditor less than half the amount of the debt while retaining to its own use a portion of the property securing the debt. The right to retain a lien until the debt secured thereby is paid is a substantive property right which may not be taken from the creditor consistently with the Fifth and Fourteenth Amendments to the Constitution." Citing with approval the Louisville case.

The court went on in the Horn case to say:

"It is clear that as to appellant, the order approving the proposed plan of reorganization which gave the debtor

the property securing the trust deed (aside from the stock of the corporation which had been sold) is erroneous and that appellant has a right to retain the lien of the trust deed as against this property. (The appellant in this case was a bondholder with $2,000 in bonds.) We need not inquire whether there can be circumstances under which the consent of two-thirds of the bondholders would be binding upon the other third. The statute so provides."

They then refer to the decision of the Seventh Circuit which I cited to you before, In re 333 North Michigan Ave. Bldg. Corporation, where the court said:

"Under Sec. 77-B, the rights of all claimants and creditors are entitled to the same protection, but they may be divided into classes, as was done in this proceeding. That law requires a two-thirds vote of each class before a plan can be confirmed, and that provision was complied with in the case before us. When a class consists of only one party, his consent must be obtained, provided his claim is affected by the plan. If, however, he is one of a class, and two-thirds of that class approve a plan which the court finds fair, equitable, feasible, and not unfairly discriminatory in favor of any class, and all classes have so consented, the remaining members of that class or classes will be bound by the plan, although their rights may be changed." Citing the Continental Illinois case; the Louisville Joint Stock Land Bank case; and the Cumberland Glass Manufacturing Company case.

The law has been very well summed up by Judge Hand, of the Second Circuit, in the case of In re Barclay Park Corp., 34 ABR NS 209, 90 Fed. (2d) 595:

"To justify a retention of a stock interest by the present shareholders it should appear that they have furnished

an additional consideration or have an equity in the estate of the debtor after the rights of the creditors are fully provided for in some way."

The court has a wide discretion with respect to allowing stockholders to participate in the plan, even though the debtor is insolvent.

In re Georgian Hotel Corp., supra.

Now, that brings us naturally to an examination of what consideration, other than cash, the stockholders in the Los Angeles Lumber Products case are giving or surrendering as a justification for the issuance of stock to them under the plan. I think before going into that I might refer briefly to three cases which will be of interest:

In re Baldwin Locomotive Works, Pennsylvania, 1937, which appears in 35 A. B. R. (N. S.) 669:

A case decided by Judge Patterson for the Second District of New York—In re Burns Bros., 35 ABR NS 714, 14 Fed. Supp. 910; and

In re A. C. Hotel Co., a Seventh Circuit case, 93 Fed. (2) 841.

In the Burns case the debtor was insolvent and there were counterclaims, substantial but controverted, asserted by the debtor against creditors holding 95% of the unsecured claims. A reorganization plan by which the claims of these creditors were subordinated to the claims of other creditors was held fair, the plan having been approved by a large majority of each class of creditors and stockholders. The court went on to say:

"On the foregoing facts, it is evident that the present plan and the two motions incident to it represent an effort

to compromise controversies among creditors and stockholders of the debtor and to relieve the debtor of its financial embarrassments by a prompt reorganization."

I cite that case particularly in the light of what shall be discussed somewhat later. In the case in the Seventh Circuit the court said:

"The expressed preference of a large percentage of all classes of security holders interested in the property, especially if well considered and apparently intelligently reached, should not be lightly set aside. Proceedings under Section 77-B are for the benefit of security holders, particularly the creditors, if the debtor be insolvent. It is their property rights that are at stake. In ventures where large sums of money are borrowed and bonds sold to the public there is difficulty in getting united, intelligent action on the part of widely scattered bondholders, many of whom are holders of but a few bonds. The Bankruptcy Law was amended to meet such a situation and to permit of effective action where two-thirds of the creditors of each class of claims favor it." Citing the Section.

I will now discuss the question of compensatory consideration.

1. The approximate investment of the bondholders and the stockholders throughout the life of the company is the same.

The court gives no consideration to that except to mention in passing that certain concessions which were obtained by the bondholders were predicated upon the putting up of $400,000 in cash, and naturally those who put up the money wanted just a little bit of a chance, in common parlance, for their "white alley", so they insisted that the bondholders do not make an immediate fore-

closure, and entered into the agreement which created, in effect, a moratorium against foreclosure until 1944.

2. At the time of the 1930 reorganization the book assets were worth only about $400,000.00; and, manifestly, if the bonds had been foreclosed at that time, that is all the bondholders would have received. They would have taken them and been out of the picture, which would have, of course, yielded only a small amount for the bondholders.

3. The old stockholders are the only persons who are familiar with the company's operations and who have had experience in shipbuilding. Their accumulated experience is of value to the reorganized company. Among their number are individuals who not only have been active in past management but who now have business contacts which will be of value to the reorganized company, these contacts being with financial institutions and with oil companies who now constitute the debtor's principal customers.

4. Most of the present bondholders are widely scattered with small holdings, and their position would be benefited by being associated with old stockholders of financial influence and stability who might be able to assist in proper financing.

5. In the 1930 reorganization, the $400,000.00 furnished by the old stockholders was, as I have just indicated, under an express agreement that there would not be any forclosure of the bonds until 1944. This means that if the modified plan is not confirmed, the bondholders will have to wait until then in order to realize upon their liens and in the meantime will be lost the present possible opportunity of participating in the proposed plan of rehabilitation of the American Merchant Marine under the

backing of the Government and the proposed new naval construction program. Furthermore, if the bondholders, through this 77-B proceeding, attempted to eliminate the old stockholders, the latter might have a right, upon the theory that the reorganization without their being in the picture would be tantamount to a foreclosure, and they might make that right effective by engaging in litigation with the bondholders to either attempt to get back their $400,000.00, or to have something done about this 1944 deferment of foreclosure.

The principal valuable consideration passing between the bondholders and the stockholders to justify any possible admission of the stockholders into the plan is the virtual abrogation of this deferred foreclosure agreement. The retention of the old stockholders to preserve continuity of management is really only a minor consideration, in the opinion of the court.

This deferment of foreclosure is a rather interesting thing. It was accomplished through compliance with the provisions of Sec. 11, Art. IX of the Trust Indenture, which appears on page 79. This provision of the original trust indenture provided, in effect, that three-fourths in amount of bonds can bind all the bonds, even to the extent of impairing the lien. In the opinion of this court, such a provision is valid, provided, of course, the modification is fair and equitable to all and does not discriminate as to any particular class. This court had occasion, several years ago, in a rather important matter, to go into that question quite fully, and found a dearth of American cases, but some English cases which seemed to be in point.

Sneath v. The Valley Gold, Ltd., 1 Ch. (Eng.) 477, 68 LTNS 602—Ch.

The Georgian Hotel Corporation case, in the Seventh Circuit, which I have referred to, seems to indicate the same conclusion. Also an interesting case is that of In re British Columbia Portland Cement Co., 22 Dominion Law Review, 609, which was affirmed by the British Columbia Circuit Court of Appeals, 1916, 27 Dominion Law Review, 726. There are quite a number of English cases on this subject. Also:

Dolph v. Cincinnati B & C R Co., 103 N. E. 13 (which was decided in 1913);

National Trust Co. v. Maritime Coal Ry. and Power Co., 2 Dom. Law Rev. 209;

Hay v. The Swedish & Norwegian Ry. Co., 5 T. L. R. 460, 461: and

Mercantile Inv. & Gen. Trust Co. v. International Company of Mexico, which is an old case, decided in the early '90's, which appears in 7 L. T. R. 616. Also:

British American Nickel Corp., Ltd. v. O'Brien, (decided in 1927) A. C. 369.

There are a number of cases that seem to indicate to this court that the provision in the trust indenture is valid and binding upon all bondholders. However, there are reasons, which will be briefly indicated later, why it may be more or less of a moot question in this case.

If the proposed plan is not confirmed, and the present proceeding is dismissed, the bondholders will be in a quandary. They cannot foreclose before 1944, without litigation which promises to be long and expensive. In the meantime the company may die of dry rot because of its inability to take advantage of any current oppor-

tunities which may be available, and participate in this revivial of the American Merchant Marine and of the new naval construction program. Even if the bondholders could have the agreement deferring the ability to foreclose until 1944 done away with they would still be faced with the provision in the Trust Indenture which requires, on foreclosure by the trustee, the consent or direction of twenty-five per cent in amount of bonds. Manifestly it would be impossible to get 25 per cent of the bonds to make that demand upon the trustee where 75 per cent were estopped by the terms of the agreement, so that the assenting bondholders, even if they had all the outstanding bonds available, would be unable to qualify on the trust foreclosure.

At the hearing before the Special Master, as indicated by the transcript, which the court has gone over carefully, and also at the hearing before this court, all bondholders who were in favor of some fair and equitable plan of reorganization seem to have agreed that the division of control of the reorganized corporation as between bondholders, now preferred stockholders, and the old stockholders, now common stockholders, is proper upon the basis of 77 per cent and 23 per cent. The only objectors, apparently, are those dissenting bondholders, like Mr. Case and his associates, who want to be paid off in full, and who are opposed to the old stockholders getting anything. There doesn't seem to be very much difference in the views among the bondholders who think the stockholders should be given participation. If they are to participate there seems to be no objection to the amount of the participation. Whether or not this court might feel that the amount of the stockholders' participation was too large or too small, or just right, isn't particularly im-

portant. After all, it has been pretty well threshed out, over a period of many months, and apparently the consenting bondholders have conceded that that is an equiable and fair division in consideration of all of the facts.

The Special Master, appointed by the court, spent considerable time upon the matter, and it was very well presented before him, and he came to the conclusion that that was a fair division, so that this court does not feel disposed to step in. This court's problem is: Are the stockholders to have anything?

In the case of In re Baldwin Locomotive Works, which I cited a short time ago, the court held that while it is recognized that the creditors have an equal right to payment of their claims, before stockholders get anything, still, as to whether a reorganization plan may be wise or foolish, the court in its exercise of the power of approval should defer to the business judgment of those whose financial interests are at stake. This court is in accord with that statement.

It may be contended that the plan can be disregarded and a liquidation can be had now under subdivision (k) of Section 77-B, after the entry of an order of liquidation. But it is doubtful whether the court would have the power to liquidate the assets covered by the trust indenture, either under sub (k) or in a separate bankruptcy, since there is very patently no equity in the property above the amount due on the bonds. The decisions are not very clear, but the principle seems sound, and I notice that judges are rather loath to provide for any such liquidation without the consent of 100 per cent of the creditors. The sale, of course, would have to be "free of liens", i.e., the bondholders' lien would be wiped out and

their interests transferred to the proceeds of the sale for satisfaction, and, while the bankruptcy court has the power to sell free and clear of liens, as appears in the case of

Van Huffel v. Harklerode, 284 U. S. 225, 76 L. Ed. 256, 52 S. Ct. 115, 18 ABR NS 730,

it seems to be very well settled practice that a sale free and clear of liens will not be ordered where it appears that the amount of the incumbrance exceeds the value of the property, as found by the court, and that is the situation indicated in the Radford case, although such a sale might be held if all lien holders' consent, or at least, do not object after they were given reasonable opportunity to consent, and have their day in court. The same thing has been held true in the Ross Island case and in

In re Zehner, reported in 193 Fed. 787.

The question of whether or no sale free and clear of liens shall be ordered is, however, in the opinion of this court, within the exercise of its sound discretion in the face of all of the circumstances. That seems to be indicated in

Central States Life Ins. Co. v. Koplar, CCA 8, 80 Fed. (2d) 754; and in

Federal Land Bank of Baltimore v. Kurtz, CCA 4, 70 Fed. (2d) 46.

The Ninth Circuit, in the Rindge case, with which you are all familiar, and also in Francisco Building Corporation v. Battson, 83 Fed. (2d) 93, held that where subd. (1)(5) of Section 77-B is resorted to in order to provide for non-assenting bondholders where less than two-thirds

in amount consent to a plan that is otherwise fair, equitable, feasible and not discriminatory, the protection provided therein for such non-assenting creditors must be completely compensatory.

Subdivision (b) (5) provides that the compensation of such non-assenting bondholders may be accorded by various methods, such as a sale of the property subject to the lien, or a sale free and clear of liens. It was held unconstitutional by the Sixth Circuit in the Tennessee Publishing Company case, as I have indicated before. However, this principle does not interest us as a practical matter here, because we have the consent of over two-thirds, and if a plan is fair, equitable, feasible and non-discriminatory under the theory of the proponents of the plan that is because it furnishes adequate compensation in the form which I have just indicated, for their being permitted to reenter the picture.

I might allude briefly to one or two of the cases which have been cited by counsel for the objectors: the Day & Meyer case, and the Prebble Corporation case, 84 Fed. (2) 73. Here the stockholders are giving up substantial and valuable rights, as indicated by the proponents of the plan, in exchange for their common stock, and they are providing a continuity of management as indicated in the Barclay case; nor do I feel but that the case of Texas Hotel Security Company v. Waco Development Co., 81 Fed. (2d) 395, might not be equally distinguished from the case at bar, because here we have the consent of some ninety-two-odd percent of the class which is being affected. In

Wayne U. S. Glass Co. v. Owens Ill. Glass Co., 91 Fed. (2d) 827,

the plan was supposed to give the stockholders control. Here the bondholders have a very substantial control by the division of seventy-seven to twenty-three.

Brunkenfeld v. N. W. Railways Corp., 82 Fed. (2d) 739.

Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482.

It does not seem to me that there is anything in either one of these cases which interferes with the plan proposed. The former bondholders are here given a preference in dividends and liquidation, which is, of course, a substantial right. I feel, of course, as I have said before, that the Rindge case is easily distinguishable.

Now, there were some other points raised by counsel for the objectors, that the plan is not fair and equitable, indicating that it destroys the lien on the bonds and gives the present stockholders an equity to which they are not entitled, and that it does not make any allowance for any unpaid interest, and that it is based upon an unfair and inadequate appraisal in that it does not take into consideration the very valuable Harbor Lease.

As heretofore indicated by the court, the extent to which the older stockholders are to be admitted in any of this reorganization proceeding is, after all, a matter for the sound discretion of the court. Under the modified plan, since the bondholders are given a very substantial majority of the new stock, as I have just indicated, they control the new corporation by having the legal capacity to elect a majority of the board. The old bondholders are given, in their new stock holdings, certain preferred rights over old stockholders, in the matter of dividends and liquidation, with which, I think, you are all familiar.

Actually the bondholders are being given everything that they could possibly get after they had gone through the labor and expense and delays incident to a foreclosure, even if the foreclosure could be held in spite of the moratorium agreement, with this exception: That they are presently foregoing a 23/100ths interest in the assets for immediate settlement. Apparently bondholders who are free, white and twenty-one, and apparently very intelligent, as evidenced by some of the letters I get, feel that a bird in the hand is worth two in the bush, and that they would rather settle on that basis, feeling that in the future they may get less if they went through liquidation than they would under the present plan.

I have already stated that there is a serious question in the mind of the court as to whether or not, if this reorganization fails, there could be any liquidation under subdivision (k) of section 77-B, or if the corporation is to be dismissed from this court, there can be any other type of foreclosure, either by trustee's sale or by a judicial proceeding.

These matters are discussed to some extent by the special master in his report, under heading No. 2, "Comment on the original and modified plan of reorganization", page 20. I think I need not go into that phase of it in detail, because I feel that it must be very apparent to counsel and to the bondholders what the situation is.

The Court does not regard that the Harbor Lease is of any value except to a going concern and unless some way is provided to make this a going concern I think it would be rather hard to realize any substantial value. There is no evidence that there is such a value that the lessors would be willing to pay a bonus to be released from it, or that the lessee can get any advantage from

transferring it. I am not entirely in accord with the objectors' method of figuring the value of the lease. I think I need not go into that except to find, as a matter of fact, that other than to a going concern, the lease has no substantial value.

The next point raised is: Although the old bondholders will have most of the stock in the new Company, they will still be dominated by the old stockholders.

After all, this is just a District Court, and we are all of us human beings, and all any of us can do is to predicate our hopes for the future upon our experience in the past, and I don't feel that that is a very substantial consideration. I have spent a lifetime in having minor interests in corporations. I have lost a lot of money in a lot of them, but it hasn't been because any of them have been trying to jyp me, but because of unfortunate circumstances, and if those unfortunate circumstances occur in the future as they have in the past, that is one of the hazards that must be taken.

The objectors also have what seems to the court an erroneous impression that the acceptance of the bondholders of the plan was obtained through the trustee with whom most of the bondholders deposited their bonds in 1930, which was done under a trust agreement, Debtor's Exhibit I. It does not seem to the court that that was the method pursued. The bonds were deposited with the trustee, and the trustee issued certificates against the deposits. The debtor did not obtain the consent of the trustee, but apparently went directly to the certificate holders and it is the individual consents of the certificate holders that support the approval of the plan. Nor do I feel that the deposit of the bonds in 1930 resulted in a loss of the lien rights to the owners of the bonds.

It is argued that by reason of the deposits in 1930 the bondholders so depositing lost their liens because of the fact that the deposit agreement transferred all right, title and interest in the bonds to the bondholders' committee.

A reading of the deposit agreement convinces the court that the deposit and transfer of title was for a special purpose, which is clear; that the bondholders retained equitable rights therein and the right to the return of the bonds when the purpose of the deposit was complied with, as indicated in the agreement. Nor do I feel that by that process there could have been a merger of title in the company, as claimed, which would tend to destroy the lien of the bondholders against the property.

We come to a discussion of the situation that the provisions of the original trust indenture, which is Debtor's Exhibit E, if valid and literally interpreted, would preclude the debtor corporation from taking advantage of section 77-B as against the bondholders or, at least, as against objecting bondholders.

Now I might explain that point: The thought is that if the moratorium against foreclosure prevented the bondholders from foreclosing by a trustee's sale, or by a judicial sale, in accordance with the alternative provisions in the trust indenture, they were also precluded from any possible liquidation under the provisions of this subdivision of section 77-B of the bankruptcy act. It may, in terms, prevent the debtor from proceeding in voluntary reorganization at all where the bondholders rights may be affected by any impairment of their lien. It seems to the court, however, extremely doubtful that it could apply to proceedings under section 77-B, which were involuntary proceedings by creditors as provided in sub-

division (a) of that section. This restriction upon the debtor's rights seem to this court, void, and that it should be so held, as being contrary to public policy. I don't believe that the company could place itself, or that the bondholders placed themselves, by this agreement, binding upon all parties, in such a position that they could not take advantage of this section of the bankruptcy act. In that connection I would refer you to

In re Weitzen, 23 ABR NS 653, 3 Fed. Supp. 698 698

Federal National Bank v. Koppel, 6 ABR NS 287, 253 Mass. 157, 148 N. E. 379.

A state or Federal court appointing an equity receiver for a corporation cannot lawfully restrain its officers from invoking bankruptcy or consenting thereto. That has been held a number of times, and the principle seems sound and analogous. I refer to

Struthers Furnace Co. v. Grant, CCA 6, 30 Fed. (2d) 579, 13 ABR NS 537.

And if such officers so act they are not in contempt of the receivership court nor are they estopped from so doing because they joined in precipitating the equity receivership or consented thereto.

In re American & British Mfg. Corp. 30 Fed. (2) 839

In the instant case, the 1930 reorganization was accomplished in a manner which resulted, among other things, in postponing the right to foreclose until 1944, and in the reduction of the interest rate. The bonds themselves on their face have a distinct reference to the trust indenture

as the instrument defining the rights of all bondholders; and the court, as I have indicated before, believes that the provisions as to the ability of three-quarters in amount to bind the balance of the bondholders, are valid.

There is an objection that there is no provision for the handling of the treasury stock, that the modified plan is silent, and simply leaves certain so-called treasury stock, which is not issued stock at all, but which is the difference between the issued and the outstanding proposed capital and authorized capital stock. But that does not seem to the court to be a valid objection for the reason that the board of directors, controlled by the stockholders, will see to it that the stock is issued for a valuable consideration, and an adequate one also, and this court has the right to assume that the officers of this corporation will do their duty and will commit no fraud. If they were disposed to do anything of the kind we have in this state a very efficient curb on anything of that kind in our state corporation department.

Objection is also made that there is no provision for non-assessability. Under the laws of California stock incorporations is not assessable unless otherwise specifically provided in the articles of incorporation.

It is true that the articles might be amended with the requisite consents, under the law of California, but that is a matter for the state of California to decide and not for this court. The court does not feel that that is objectionable.

I have already stated that the acceptance of the plan by a large percentage of the parties interested, is strong evidence to the court that it is fair and feasible, and that it is made in good faith, particularly where the matter has

been under discussion for such a long period of time. I think the Court may safely say that a lot of very bright minds have been delving into this, and have felt that on the whole the interests of the bondholders were better protected by following the plan. It is, of course, true that a court of equity will not allow minority bondholders to be disregarded, or unfairly treated in a reorganization plan, yet, on the other hand, it will not lend its aid to a claim by a minority bondholder which may result in holding up a fair reorganization plan solely as a means of obtaining greater value, or more favorable returns for his or her bonds than would be given to the majority of the bondholders.

I want it very definitely understood that this court does not believe that Mr. Case and the other objectors are in here with the idea of holding up this proceeding in order to shake down the rest of you to pay them off. In fact. I would state from my knowledge of men, that this is not the case. However, it is unfortunate that the effect is just exactly the same as though he were doing that very thing. That is the legal effect of it is exactly the same and this court believes that it was to avoid the abuses incident to the old bankruptcy situations that 77-B was passed by the Congress.

So far I have been talking largely to the attorneys who, through years of training and experience, are familiar with the technical difficulties which the court has encountered in this matter. I don't think that I should leave it there. There are a number of bondholders in court and a number of bondholders have taken a great interest in this matter, as have some of the stockholders. I would like to just talk a little bit to the bondholders who are present here in court, and who are, after all, the parties most

directly interested, and many of whom, are not represented by counsel; and one with a small bond interest could not afford to hire counsel, and I think that by and large that is what I am here for.

After all, this is a bankruptcy court. What does that mean? It simply means that the corporation which is before the Court cannot pay its debts and it has therefore come into this court to indicate that it is insolvent and to have the court give it protection so that its remaining assets might not be unfairly dissipated. Now, we are in this position: We have to deal with the situation as we find it today. We can't hark back to the time when this corporation was organized, with its hopes and aspirations, nor to the time when the debts here in question were created. When you good people invested your money in the bonds of this corporation, you were investing your savings in order to obtain a little income. You had no intention of buying any interest in the business of the Los Angeles Lumber Products Company. Now, unfortunately—and without any fault on your part—the assets of the corporation due to conditions which could not possibly have been anticipated, have been greatly depreciated in value. Likewise, business operations have been unsuccessful, again due to unexpected circumstances, so that operations which previously resulted in a profit now either result in no profit or in a very substantial loss. Of course, that is most unfortunate and yet, in all fairness, no one seems to have charged the managing officers of the corporation with any non-feasance or malfeasance. They have apparently done everything within their power to save the situation, and there has been no charge of wrongdoing. It is just one of these combinations of circumstances that we have become very familiar with during the last two years.

Now, in spite of literally years of effort and because it was manifestly impossible to get the consent of one hundred per cent of the bondholders and stockholders to any plan of reorganization, the debtor corporation placed itself under the protective mantle of this Federal Court. The act under which it crept, as you know, is Section 77-B, which is a comparatively new amendment to the bankruptcy act. Now, it really doesn't make much difference what the form of the proceeding is by which this corporation came into this court. The main thing is that it is here, and that this is a court of equity, and, as a court of equity, and realizing that these assets are not capable of being liquidated so as to realize a substantial amount on your bonds, this court has been sitting here attempting, in all fairness, to look after the interests of the bondholders. I have not any particular interest in the stockholders except to use them in what seemed to be the best possible way to turn it to profitable account for the benefit of the bondholders. That is perfectly proper for this court, because, after all, if the bondholders can't be paid they are the ones that are mostly interested; and the Court does not propose to give these stockholders any more than is absolutely necessary in order to accomplish the desired result. Even under the most favorable circumstances, the evidence seems to show to the court that a sale of the assets and the distribution of the net proceeds among the bondholders would not give them a net return of more, in any event, than two or three hundred dollars on a thousand dollar bond. As a matter of fact, the court is very doubtful whether, with forced liquidation, under existing conditions, the bondholders would realize more than a hundred dollars on a thousand dollar bond. I think the amount of 25% is excessive in the ability to realize it on a forced sale.

Now, this is most distressing to the court but, unfortunately, there is nothing that the court can do about it. This court has to take things as it finds them. But you may be very sure that I am most sympathetic, because I know from past experience, very sad experience, just how distressing it is to face substantial losses in investments. You can't, as the saying is, get blood out of a turnip. There is just so much in assets, and we have got to divide these things up in such a way as to do the best we can for the bondholders. I recently received a letter from one poor woman who owned a thousand dollar bond. In that letter she said, "Judge, I don't want any stock. I want my money." I wish she could get it. I don't blame her a bit for wanting it, because I know the poor woman needs it; but there is no way in the world that this court can stretch those assets so that she can get her money.

We must meet the situation fairly and squarely, and not attempt to fool ourselves and I would like to show you people as laymen, some of the difficulties in plain, every day English that is not meant for lawyers. We are dealing with present circumstances, as I have said, and not with past hopes and prospects. We are here to do the best we can and, as I see it there are only four things that I can legally do. After all, this corporation is in here under a law which was passed by Congress to accomplish that end.

The first thing I could do would be to reject this plan and dismiss the proceeding.

The second thing I could do would be to reject the plan, but not dismiss the proceeding. I could keep the case here in court and order liquidation and sale of the property through subdivision (k) of section 77-B, to which I have referred previously.

Or, I could reject the plan and notify the corporation that I proposed to dismiss the proceeding, but give them time to file a voluntary petition in bankruptcy, or to give some creditor enough time to file an involuntary petition in bankruptcy under which there would be a liquidation under the normal processes of the bankruptcy court.

The fourth choice that I have is to approve the plan before the court. I don't feel that, under the circumstances, there are any other alternatives open to me.

Now, let me just tell you bondholders what may happen under each one of the three possible methods of handling this situation, other than the approval of the plan. Let us take the first plan that I suggested, that is, the first method, rejecting the plan and dismissing the proceeding. By that, I mean that the corporation would be put out of court, and would not be given any right to have relief under section 77-B of the bankruptcy act; tell the corporation that it must discard the protective mantle of this court and let nature take its course. Now, that sounds very simple, and it would relieve this court of a lot of worry but what about the poor bondholders? Theoretically, they would have a right to immediately start foreclosure under the terms of the trust indenture. This could—also theoretically—be done either by a sale through the trustee, the bank, or by a sale by other judicial proceedings which are authorized by law and the trust indenture. However, this is not as simple as it sounds. Why? Because, in a prior reorganization, and apparently strictly in accordance with the provisions of the original trust indenture, the holders of more than 75 per cent in principal amount of the bonds, agreed to a moratorium until 1944 as far as foreclosure is concerned. I have aleady explained that I believe that that provision is valid, but even if it were not valid, inso-

far as it would bind the non-assenting bondholders, that is, those who did not assent to the moratorium as a practical matter, the bondholders are not very much better off because 25 per cent in amount of the bonds cannot be obtained to force a foreclosure through a trustee, and if any other type of proceeding, such as a judicial sale were attempted, naturally the stockholders would attempt to restrain the proceeding in accordance with the terms of the moratorium agreement, which would result in great expense and delay.

Now, let us take the second choice; that is, the rejection of the plan and liquidation under subdivision (k) of the act. I have already explained the legal difficulties incident to such an attempted liquidation. Under the circumstances, this court believes that such a liquidation would be impractical, would delay proceedings and would be very expensive. The stockholders would undoubtedly have to litigate the right under that act in face of the moratorium agreement, which would add to the expense and it is quite possible that such litigation would go as far as the Supreme Court of the United States before it was finally determined.

The third possibility is a dismissal of the proceedings, permitting the corporation to go into bankruptcy in the regular way for liquidation. All the objections to the second plan are certainly appropriate under this plan and would involve the appointment of a new trustee etc. which would be very expensive process. We haven't any choice about going along in the same way as the corporation

operated prior to the filing of this proceeding; that is, to permit things to return to the status quo ante. The officers refuse to continue under such an arrangement, because they feel they can't function efficiently with any hope of business success. I think they feel there is no way for them to finance jobs; no way for them to convince the people who are interested in shipbuilding contracts that they are financially in a position to meet their commitments. They indicated their hopelessness in the entire situation by filing this petition. So we really have very little choice. We may, if such an action is possible, wash up the whole affair and put it through the wringer. If we do that, in my judgment, it will return a very small amount to the bondholders. The only hope, it seems to the court is to create a situation where the corporation can go ahead and take advantage of the possibilities of the immediate future. If I were a bondholder I would rather take my chances that these officers would salvage some of my loss, than to let this corporation be, as I described it, put through the wringer. I would rather give them a chance to make a success and to pay me back some of the money that I had invested. I cannot feel, or would not feel, that this is a proper time for forced liquidation, and that the price of getting a few immediate dollars would be too great to pay in the face of immediate possibilities.

I would feel that, with the recovery program which is now initiated by the Government by which shipbuilding is to be encouraged, with the possibility of a considerable naval program, that it would be very sensible to put this

corporation in shape to take advantage of some of these almost certain profitable contracts.

After all, it is a matter of common knowledge that the Government is not driving a hard bargain in these contracts. They are, to some extent at least, a part of the relief program in which we are all interested, either at heart or through our structures, and we have either got to put people on the dole or we have got to put them to work, and this is just another way of putting them to work.

To make a long story short I would rather take half a load if I were a bondholder than to have practically no bread. If values, on liquidation, are almost certainly pretty close to the bottom, why not take the chance of sacrificing this 23/100 per cent of the present liquidating value of the property against the strong possibility of a successful operation? Now, if there isn't a successful operation in the future, the bondholders control this corporation and they can put it through the wringer themselves in a much less expensive manner than this court could ever put it through, because they can elect directors who will order a sale of the property, and if there is a better market for this type of property that would offset their 23/100 per cent. Of course, if, as is anticipated by these managing officers, they can make a success of the undertaking there is the possibility that there might be a very substantial recovery for the bondholders. It is perfectly apparent to me that the bondholders feel that that is the situation or such a large percentage of them would not have consented to the program.

I am familiar with the proposals in these cases to pay the non-assenting bondholders off and get rid of them. I don't approve of that action. I see no reason why any portion of the other bondholders' money should be diverted to pay any bondholder, and I think that very one here will agree with the principle behind that, including the objectors' themselves, whose attitude has always been so very fair in their presentation of the matter. I think as I have explained, that is one of the reasons why section 77-B was placed on the statute books.

There is one other element here that had some influence in the conclusions of the court. I believe it is necessary if an attempt is to be made to put this corporation back on its feet as a going concern. To dilly-dally around over a period of many weeks or many months, would almost certainly result in a very heavy loss to the bondholders. It was for that reason that this court appointed the special master and for that reason that the court has kept such careful track of the proceedings in this matter from beginning to end, in order that it would not be necessary to have this reorganization stretch out over a period of months or years. If we are going to do anything, let us get at it.

The court has already indicated its feeling with regard to these tax matters. The motion of the government will be denied. The court will keep jurisdiction of this case, and settle these tax matters as it feels just.

The spirit of the motion of the proponents of the plan is approved by the court. There is considerable extrane-

ous matter in the form of the motion, which is objectionable to the court.

The court will ask counsel to prepare the motion in its more formal form for signature. It was prepared as an oral motion, and was only handed to the court at the court's request.

There has been a request by the proponents and others that the special master be continued in his services in order that the plan might be expedited. I am in accord with that.

I see presently no reason for 90 days in which to elect the board of directors. I counsel every one to get right at this thing and have it move along. I think, even in the face of an appeal from the decision of this court, which is, of course, perfectly proper, and perfectly within the right of those who oppose the plan, that there might be a considerable movement along the lines indicated. The court in any event, will continue its jurisdiction.

I am not very favorably disposed to the provisions of 77 B, as they are worded, keeping the debtor in possession. That I have heretofore indicated, and yet in this proceeding I am going to overcome my prejudice, for the present at least. The order of the court permitting the debtor to remain in possession will be continued until the further order of the court. However, the court will require a bond satisfactory in form, wording and obligation, to be furnished in the penal sum of $50,000. The purpose of that is to avoid any possibility that there might be any loss of property which is a proper part of the estate. The

form of that bond will be submitted to the special master by the special master to the court or directly to the special master and to the court.

Exceptions will be allowed to all of the rulings of the court. To the proponents an exception will be allowed without further action on the part of the court, to the final form of the order approving the motion, which I shall ask counsel to submit to all counsel for the opposing parties and a copy also to the special master.

Let is be understood by all parties that the court has simply been informally, and more or less contemporaneously, giving to counsel and to the bondholders present its idea of the law and the facts, and its views as to the propriety of debtor's objective.

Counsel for the debtor is directed to prepare findings of fact and conclusions of law and to form a tentative decree which will embody insofar as the same is necessary, the statements of the court made here today. This order will then be submitted to all interested counsel, to the master and to the court for final approval as to form and substance.

I again want to thank counsel in this case and the special master for their very prompt and diligent attention to these matters and the very fair way in which everything has been presented.

[Endorsed]: Filed R. S. Zimmerman Clerk at 52 min. past 4 o'clock, May 10, 1938 P. M. By M. J. Sommer, Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

OPINION OF THE COURT

APPEARANCES:

For Debtor: Faries & McDowell, by David R. Faries and J. Clifford Argue; Gibson, Dunn & Crutcher, by J. C. Macfarland and Stuart Lapp.

Bondholder Thomas K. Case: In propria persona.

For Bondholders Ogden, et al: George R. Larwill and Frank S. Balthis, Jr.

Bondholder William Schoenau, Jr: In propria persona.

For Bondholder Adele M. Cowan: Clarke & Bowker, and Earl E. Moss.

For Bondholders Coulter and Priest: Overton, Lyman & Plumb, by C. L. McGaughey.

RALPH E. JENNEY,
Judge.

STATEMENT OF FACTS

This is a proceeding for the reorganization under Section 77-B of the bankruptcy Act, of Los Angeles Lumber Products Company, a California corporation. The original petition contained a proposed plan of reorganization. A special master was appointed by the court to examine and report all facts connected with the reorganization and to make recommendations as to the advisability of approving the plan. Subsequent to this reference the plan was amended and the Special Master filed his report recommending confirmation of the amended plan; which for convenience will be referred to herein as the "plan".

After a hearing, upon proper notice to all parties in interest, the court made an interlocutory order confirming the plan. This order was called an interlocutory one for the reason that, to perfect the plan, debtor was required to form a new corporation to take over its assets, and permission to issue stock of the new corporation had to be obtained from the Division of Corporations, in accordance with the provisions of the Corporate Securities Act of the State of California. The permit having been secured and a hearing having been held upon proper notice, application is now made for a final order of confirmation.

No opposition to the plan was presented other than by Thomas K. Case and Adelle Cowan, two bondholders, holding a total of $18,500.00 face value of debtor's bonds.

Los Angeles Lumber Products Company is a holding corporation which owns all of the capital stock, except directors' qualifying shares, of six subsidiary corporations. Three of these subsidiaries are without assets and are ready for dissolution. Of the other three corporations, two have assets of little value, which are to be sold as soon as possible, and dissolution of the corporations affected. The only subsidiary having substantial assets is Los Angeles Shipbuilding and Drydock Company, a California corporation.

This subsidiary is engaged in building and repairing merchant vessels and small naval craft in its shipyards located upon some sixty-eight acres of tide land at Los Angeles harbor. Its main assets comprise a complete ship-repair and shipbuilding plant and cash on hand. At present its operating activities consist principally in the repairing of merchant vessels, although it was originally organized during the world war to carry on and did carry

on an extensive program of ship construction. During its busiest years, the corporation employed several thousand men and did a gross volume of business running into many millions of dollars. After peace was declared and the demand for new bottoms declined, debtor's business decreased materially. In 1924 debtor issued and sold $3,897,071.88 principal amount of its First Lien and Collateral Trust Twenty Year Seven and One-Half Percent Sinking Fund Gold Bonds. This bond issue was secured by an hypothecation of all the capital stock, except directors' qualifying shares, of debtor's subsidiary corporations, and by a mortgage or trust deed lien upon debtor's fixed assets. There are presently outstanding of this bond issue $2,565,500.00 face value, interest upon which is delinquent since February 1, 1929.

In 1930 the debtor again became financially embarrassed and a reorganization was effected, out of court, through the medium of a bondholders' protective committee. Under the arrangement consummated at that time consenting bondholders waived any right to enforce stockholders' liability against the holders of a large proportion of the outstanding capital stock. It should be noted that the original Trust Indenture securing the payment of the company's bonds, and particularly Section 2 of Article IX thereof, provided that the bonds or the Trust Indenture might be amended by a Supplemental Indenture executed by the debtor, its principal subsidiary, the Los Angeles Shipbuilding and Drydock Company, and the trustee, with the consent of the owners or holders of at least seventy-five percent in principal amount of the bonds outstanding; or, with the consent of the bond underwriters and the owners and holders of at least a majority of the bonds outstanding. There was a restrictive clause, however, which provided that no amendment of the bonds or Trust

Indenture should be made which might create any discrimination among or between outstanding bonds.

The Trust Indenture also provided that neither debtor corporation nor any of its subsidiaries would seek any injunctive relief, or plead, or take advantage of any valuation law; appraisement law, stay law, or any other law,—whether then in force or thereafter enacted,—which might in any way alter, impair or impede the rights or remedies of bondholders or the trustee under the Trust Indenture; or which might affect the time, place, means or mode of enforcing such rights or remedies. Acting under the power so given in the original Trust Indenture, a Supplemental and Amended Trust Indenture was properly executed with the consent of the holders of ninety-seven percent of the outstanding bonds; by the terms of which, among other things, the interest rate on the bonds was reduced from seven and one-half to six percent; and the right to foreclose under the Trust Indenture, for failure to pay interest unless earned, was waived until 1944, the maturity date of the bonds.

In consideration of these amendments certain stockholders of debtor contributed $400,000.00 to the capital of the corporation, and the bondholders who consented to this arrangement deposited their bonds with a trustee, certificates of deposit being issued therefor. The Articles of Incorporation of the debtor were also amended to provide for Class A and Class B shares without par value, which were issued in conformity with the terms of a permit from the Division of Corporations of the State of California. There are now outstanding 57,788 shares of Class A stock and 5,112 shares of Class B stock of the debtor.

In 1937 another reorganization was attempted under a plan which the said California Division of Corporations,

after proper hearing, deemed to be fair and equitable. Financial difficulties had arisen largely because debtor and its principal subsidiary, Los Angeles Shipbuilding and Drydock Corporation, were unable to secure credit, due to debtor's top-heavy bond structure, nor were they able to secure faithful performance bonds which were essential to the undertaking of any shipbuilding contracts. All fixed assets of the Los Angeles Shipbuilding and Drydock Company, appraised at $465,000.00 by the American Appraisal Company, were directly subject to the lien of the Bond Indenture. Its other assets, including cash, accounts receivable, inventory, supplies, etc. were estimated to have a value of approximately $365,203.23. These last mentioned assets were not directly subject to the lien of the Trust Indenture securing debtor's bonds, but the capital stock of the operating subsidiary as well as that of the other subsidiaries was held by the trustee, as hereinbefore indicated, as additional security for the bonds.

In connection with the filing of the petition herein, a plan of reorganization was proposed which, briefly stated, contemplated the formation of a new corporation, to be known as Los Angeles Shipbuilding and Drydock Corporation, which corporation was to acquire, free and clear of liens, all of the assets of debtor; except the capital stock of Masset Timber Company, Ltd. and Puget Sound Lumber and Box Company, two of the debtor's subsidiaries, which were to be liquidated and the proceeds from liquidation distributed pro rata among bondholders. The new corporation was, according to the plan, to have an authorized capital stock of One Million Dollars ($1,000,000.00) of the par value of $1.00 per share. 830,000 of these shares were to be presently issued as follows: 590,065 to bondholders, pro rata, on the basis of approximately 230 shares per each $1000.00 bond, and

239,935 shares to the holders of the Class A stock of the old corporation who had, in 1930, contributed the $400,000.00, and who were largely responsible for the management of the corporation. The balance of the authorized capital stock, or 170,000 shares, was to be sold for cash, to raise additional working capital. Thereupon debtor and all remaining subsidiaries were to be liquidated and dissolved.

By the terms of the proposed plan of reorganization, the capital stock of the new corporation was made non-assessable and the Board of Directors was to continue as theretofore until new stockholders elected their successors. All creditors of the debtor, other than bondholders and debtor's subsidiaries, and all expenses of administration, were to be paid in cash. Under the proposed plan bondholders were to receive approximately seventy-one percent of the capital stock of the new corporation, immediately to be issued, and Class A stockholders of the debtor were to receive twenty-nine percent. Class B stockholders,—practically all of whom were also bondholders,—were to receive nothing. The original plan was properly accepted by the holders of over ninety percent, in amount, of the outstanding bonds; over ninety-nine per cent, in amount, of outstanding Class A stock, and over eighty-nine percent, in amount, of Class B stock.

Since the beginning of debtor's operations, the aggregate investment of the Class A stockholders was approximately equal in amount to the face value of the bonds still outstanding; that is, approximately Two and One-half Million Dollars ($2,500,000.00). The responsibility of management has fallen continuously upon these Class A stockholders or upon directors sponsored by them. It appears that these directors and stockholders are considered to be of importance to the company because of their ex-

perience and contacts in connection with shipbuilding operations. The evidence shows that, in 1930, when the Trust Indenture securing debtor's bonds was amended, these Class A stockholders put up approximately $400,000.00, in cash, to keep debtor's business going; and that had there been a foreclosure at that time, the bondholders would not have realized more than $400,000.00 from the sale of the security held under the Trust Indenture.

The evidence shows that the bondholders are not now in a position to foreclose because, by the terms of the amended Trust Indenture, no default can be predicated upon a failure to pay interest unless earned—and that the interest has not been earned. This relief from the possibility of a default under the bond issue was one of the main considerations, running to the Class A stockholders when the additional capital of $400,000.00 was provided.

The evidence further shows that the United States Government is planning the construction for its navy of many warships and auxiliary vessels, including minesweepers, oil-tankers, freighters, coastguard cutters, and ships of that general type. The shipyards of debtor and its subsidiary are equipped for and are capable of building many of these ships. It is further indicated that the United States Government is planning an expansion of its merchant marine in Pacific waters, and that at least some of this construction might well be allotted to debtor's shipyards. In order to take advantage of this situation, interested parties feel that debtor should proceed immediately to make the changes necessary to permit this additional ship construction and to provide sufficient working capital so that contracts can be obtained. Otherwise the liquidating value of the plant is problematical, being variously estimated at from $100,000.00 to $300,000.00. Of approximately 757 holders of debtor's outstanding

bonds, 24 of them own or hold $1,208,000.00 face value. The other 733 bondholders are widely scattered and hold from $500 to $10,000, totalling $1,364,700.00 face value. Most of these bondholders are persons who have not been active in the business of debtor and are not at all familiar with shipbuilding.

The evidence shows that debtor corporation is insolvent in both the bankruptcy sense and the equity sense; that is that the debtor's assets, at a fair valuation, are sufficient to pay only a small percentage of its debts, and that debtor cannot hope to pay its debts as they mature in the ordinary course of business unless a reorganization is effected.

During the hearings before the Special Master, the plan of reorganization as originally proposed was amended so that bondholders now are to receive approximately seventy-seven percent of the capital stock of the new corporation, presently to be issued, instead of seventy-one percent, as originally planned, and the old Class A stockholders will receive twenty-three instead of twenty-nine percent. Also the capital stock of the new corporation is to be divided into Class A and Class B stock, all shares having equal voting rights per share, but the Class A stock having preference upon liquidation to the extent of the par value thereof, and having preference as to non-cumulative dividends in any year up to five percent. Under this amended plan, bondholders are to receive entirely Class A stock. 830,000 shares of an authorized capital of one million shares of $1.00 par value are to be presently issued as follows: 641,375 shares of Class A stock to bondholders, pro rata, on the basis of about 250 shares for each $1,000.00 bond; 188,625 shares of Class B stock to the holders of the Class A stock of debtor corporation.

The balance of the authorized capital, amounting to 170,000 shares of Class A stock will be sold to furnish additional working capital.

The plan has been properly approved in writing by the following:

(a) The owners and holders of 92.81 per cent face value of debtor's outstanding bonds;

(b) 100 per cent, in amount, of other creditors;

(c) The owners and holders of 99.75 per cent of debtor's outstanding Class A capital stock;

(d) The owners and holders of 90 per cent of debtor's outstanding Class B capital stock.

No objection has been made to the approval of the plan by any stockholders or creditors, except by the owners and holders of a total of $18,500.00 face value of debtor's outstanding bonds.

Extended hearings have been held both before the court and before the special master, who, in his formal report recommends, without reservation, approval of the plan.

Other facts will appear from the opinion.

JENNEY, District Judge (after stating the facts as above, rendered the following oral opinion from the bench):

There are a number of interesting legal problems which have been presented orally and by briefs to the court.

The first issue to be considered is the constitutionality of Section 77-B of the Bankruptcy Act, which has been questioned by counsel for the objectors, but which has never been passed upon directly by the Supreme Court of the United States. That court has however held constitutional Section 77, relating to railroad reorganizations,

which are in many respects similar to the corporate reorganizations intended to be covered by Section 77-B.

Continental Ill. National Bank & Trust Co. v. Chicago R. I. & P. Ry. Co., 294 U. S. 648, 27 ABR (NS) 715, 79 L. Ed. 1110, 55 S. Ct. 595.

While the Court of Appeals for this Ninth Circuit has not passed on the matter, the Circuit Courts of *Appeal* of the Second, Fourth, Seventh and Eighth Circuits have all held Section 77-B to be constitutional.

In re New Rochelle Coal and Lumber Co., 29 ABR (NS) 177, 77 F (2d) 881, (Second Circuit);

Campbell v. Alleghany Corp., 27 ABR (NS) 504, 75 F. (2d) 947 (Fourth Circuit);

In re Georgian Hotel Corp., 31 ABR (NS) 234, 82 F. (2d) 917 (Seventh Circuit);

Grand Boulevard Investment Co. v. Strauss, 29 ABR (NS) 188, 78 F (2d) 180 (Eighth Circuit).

No Circuit Court of Appeals, District Court, or state court, so far as any reported decision reveals, has held the section as a whole unconstitutional.

The decision in Tennessee Publishing Co. v. American National Bank, 30 ABR (NS) 521 81 F (2d) 463, has been heavily relied upon by counsel for the objectors. It seems to this court to be distinguishable in principle. An analysis of that case shows that the lower court found the proceeding instituted in good faith, but declared subsection b-(5) of Section 77-B, in so far as it purports to permit adjustment of liens without the consent of the lien holders, invalid under the Fifth Amendment to the

Constitution. That case was appealed, and the Circuit Court found that the Plan of Reorganization which had been presented to the District Court, and which, of course, was a part of the record on appeal, was hopelessly unworkable. The appellate court said that it was apparent from the record that the company had had operating losses for such a length of time that it seemed impossible, under the plan presented, to turn those deficits into profits; that there was no reasonable prospect for the rehabilitation of the debtor. The appellate court, therefore, held that the plan was not filed in good faith, and was not a feasible one. The court admitted that because of its finding of lack of good faith, the question of the constitutionality of subsection b-(5) was perhaps not necessary to be decided. It then went on to say that because other plans of reorganization might be presented to the court below after remand, it would nevertheless determine the constitutional question, rather than leave this subject open. It then sustained the decision of the lower court and held the provisions of subsection b-(5) unconstitutional. It stated that under the Fifth Amendment to the Constitution, the lien holders had rights under their contract, to retain their lien, to public sale, and to have the mortgaged property devoted to the satisfaction of the debt, etc.

The decision of the Circuit Court was affirmed by the Supreme Court in 299 U. S. 18 (81 L. Ed. 13, 57 S. Ct. 85, 32 ABR (NS) 180) on the ground that the plan was not feasible and not presented in good faith, but the court declined to pass upon the constitutional question.

In the opinion of this court, Section 77-B of the Bankruptcy Act is constitutional. The question is whether or not the law authorizes the court to adjust the debts and obligations of an embarrassed corporate debtor, unable to pay its debts as they mature, without making a formal

adjudication of bankruptcy or taking possession of its property for distribution among creditors, and whether that power may be sustained under the power over bankruptcies vested in Congress. The grant of power to Congress to establish uniform laws on the subject of bankruptcies does not seem to be limited to the forms in which that power has heretofore been exercised by Congress, or by the laws relating to bankruptcies which have been passed in this country or in England or even in the several American Colonies prior to the adoption of the Constitution.[1]

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[1]The court refers those who may be interested to articles appearing in 12 New York Univ. Quarterly Review 198, and 21 American Bar Association Journal 47.

All phases of the relationship between a financially embarrassed debtor and his creditors, are brought under the control of Congress by the Constitutional grant of power. The fact that a particular mode has heretofore been employed in dealing with this relationship should not, it seems to this court, be taken as a measure of the power of Congress to enact legislation in that regard. See:

Hanover National Bank v. Moyses, 186 U. S. 181;
Sturges v. Crowinshield, 4 Wheat. 122;
In re Landquist, 70 F (2d) 929;
Nelson v. Carland, 1 How. 265;
In re Reiman, 7 Ben. 455; 20 Fed. Cas. 490

In view of the statements contained in the opinion of the Supreme Court of the United States in the case of Louisville Joint Stock Land Bank v. Radford, 295 U. S.

555, 79 L. Ed. 1593, 28 ABR (NS) 397, 55 S. Ct. 854, respecting the power of the majority of a class to bind a minority in composition matters, it seems likely that the Supreme Court would hold Section 77-B constitutional, if the question were squarely presented to it. In the abscence of any such definite decision on the part of that court, it becomes the obligation of this court to do the best it can under the circumstances. That court would we believe, hold that a lien, otherwise valid under Section 77-B of the Act, could be impaired where the lien holder is a member of a class and the requisite two-thirds in amount of that class consent, and the plan of impairment is found by the court to be fair, equitable, feasible and not discriminatory. In that connection see:

In re Central Funding Co., C. C. A. 2, 75 F (2d) 256, 27 ABR (NS) 764;

Downtown Inv. Assoc. v. Boston Met. Bldg., C. C. A. 1, 81 F (2d) 314, 30 ABR (NS) 483; which, although not quite so directly in point, is a later case;

Canada Sou. Ry. v. Gebhard, 109 U. S. 527, 3 S. Ct. 362, 27 L. ed. 1020.

In Campbell v. Alleghany Corporation, supra, Judge Parker of the Fourth Circuit, said in substance that it is no ground of constitutional objection to the Corporate Reorganization Amendment that the Act relates only to corporate debtors, as the uniformity required by the Constitution is geographical and not personal. He indicated that Section 77-B, authorizing a court to readjust the

debts and obligations of an embarrassed corporate debtor, without making formal adjudication of bankruptcy or taking possession of its property for distribution among creditors, is within the power over bankruptcies vested in Congress by the Constitution.

A statute requiring secured creditors of a corporation to scale down their debts in accordance with the plan which two-thirds of them are willing to accept and which has been approved by the court as reasonable and fair, and accept in lieu of payment in money such securities as are specified in the plan, is not, he said, such an arbitrary and unreasonable exercise of the bankruptcy power as to amount to a denial of due process.

The fact that secured debts are affected by the Corporate Reorganization Amendment does not impair its constitutionality. Likewise, there is nothing relating to stockholders in that Amendment which affects its constitutionality, for like other constitutional grants of power, that giving Congress power over bankruptcies is to be interpreted, not in the light of the conditions with which the framers of the Constitution were familiar, but of what is required under modern conditions to deal adequately with the relationship existing between embarrassed debtors and their creditors.

The acceptance of a proposed plan by a large percentage of the parties interested is strong evidence that it is fair and feasible, and that it is made in good faith. While a court of equity will not allow minority bondholders to be disregarded or treated unfairly in a reorganization plan, yet, on the other hand, it will not lend its aid to any scheme of minority bondholders opposing a fair reorganization plan solely as a means for obtaining greater value or more favorable terms for their bonds

than are to be given by the plan to the great majority of the bondholders.

Palmer v. Bankers' Trust Co., C. C. A. 8, 12 F. (2) 747, 754.

Downtown Inv. Assoc. v. Boston Met. Bldg., supra.

In the latter case Judge Morris summed up the situation this way:

"Some of the tests applied by the Supreme Court in dealing with the question of whether a plan of reorganization is fair and equitable in equity receivership proceedings are that the plan must not exclude any creditor from participation under the penalty of the plan being declared a fraudulent conveyance and that it must not disregard the priority of any class of creditors. In the case of Kansas City Terminal Railway Co. v. Central Union Trust Company, 271 U. S. 445; 454; 46 S. Ct. 549, 551, 70 L. Ed. 1028, it was said with reference to a plan of reorganization:

" 'But "no such proceedings can be rightfully carried to consummation which recognize and preserve any interest in the stockholders, without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation. In other words, if the bondholder wishes to foreclose and exclude inferior lien holders, or general unsecured creditors and stockholders, he may do so; but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and preserve the prior rights of general creditors thereof. This is based upon the familiar rule that the stockholders' interest in the property is subordinate to the rights of creditors, first of secured and then of unsecured creditors.

And any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation." Louisville Trust Co. v. Louisville Railway Co., 174 U. S. (674), 683, 19 S. Ct. (827) 830 (43 L. Ed. 1130).'

"From this it would seem that no plan is fair and equitable that does not recognize the prior rights of creditors. See, also, First National Bank v. Flershem, 290 U. S. 504; 54 S. Ct. 298, 78 L. Ed. 465; 90 A. L. R. 391.

"One of the impelling reasons for the passage of 77-B by the Congress was to provide a simpler method for the reorganization of corporations laboring under financial embarrassment due to over-capitalization and excessive fixed charges resulting from easy credit and excessive expansion of more prosperous days. It was necessary to devise a law to prevent unreasonable minorities from blocking fair and equitable plans of reorganization which they could do prior to the passage of 77-B."

All of us know from sad experience that one or two recalcitrant bondholders were able, under the old methods, to hold up very definitely beneficial plans until they were paid off 100 cents on the dollar. Continuing, Judge Morris said:

"In order to accomplish the desired purpose Congress turned to the principles of the Bankruptcy Act passed in 1898. This had stood the test of constitutionality. And as we view it, 77-B is but an extension of the doctrine of composition provided in Section 12 of the original Bankruptcy Act.

"Reorganization plans under 77-B may differ from offers in composition in form and complexity, but the dif-

ference is little more than one of degree. A plan of reorganization when accepted is nothing more than an agreement between the debtor and its creditors and stockholders, or if the debtor has been declared insolvent, then between the several classes of creditors. When such contract or agreement has been accepted by the requisite majority of creditors and stockholders, the principle long recognized in composition cases steps in and under the supervision of the court imposes upon objecting minorities the will of the majority. This could not be accomplished under the acid tests applied to equity receiverships before the passage of 77-B.

"We therefore hold that Section 77-B does not require that every plan approved as fair and equitable shall be of such a character that it would withstand attack by nonassenting creditors asserting their strict legal rights unaffected by any principles of the Bankruptcy Act.

"To hold that the phrase 'fair and equitable' has the same meaning when applied to a reorganization under 77-B as it had in equity receiverships, is to eliminate from it to a certain degree the rights of creditors and stockholders to adjust their respective rights by contract and nullify provisions of the Act which was passed to facilitate corporate reorganizations."

Let us then consider the other main points raised by those objecting to the plan.

The first point is this: Under the modified Plan, bondholders, without the consent of all of them, would be deprived of certain substantial rights, such as: the right to foreclose their mortgage or Trust Indenture, to have a judicial sale of the mortgaged or hypothecated property under the direction of the court, to bid at that sale on the security under the Trust Indenture, the right to en-

force stockholders' liability on a deficiency claim against present stockholders of the debtor corporation, and so forth.

As to stockholders' liability: Present objectors and all nonassenting bondholders,—who, combined, apparently hold less than seven and one-half per cent of outstanding bonds—once might have had the right to sue stockholders upon California's previous statutory stockholders' liability. However, nearly all of the bondholders some time ago expressly waived this liability; and, in any event, under the terms of Article IX, Section 2 of the Trust Indenture and proper proceedings taken thereunder, stockholders' liability was waived on behalf of all bondholders against most of the stockholders. Objectors insist that this waiver is invalid as to them because they did not expressly consent thereto. But the owners of more than three-fourths in amount of all outstanding bonds did so consent—strictly in accordance with the requirements of the Trust Indenture for amendment; and, as will be seen later, this Court believes that such a provision for amendment of the Trust Indenture is valid and binding.

It should be noted that, even if there had been a judicial sale under foreclosure and a deficiency judgment, the bondholders would not thereby have had any claim against stockholders which could be enforced in this proceeding. The bondholders would still be subject to Section 4 of the Bankruptcy Act, which does not give this court power to determine any issue of stockholders' liability not passing to the trustee in bankruptcy.

As hereinbefore indicated, if there were only one lien holder, or bondholder, the contention of the objectors to the plan,—that the secured debt could not be scaled down without the consent of that one bondholder,—would be

supported by authority, viz: Louisville Joint Stock Land Bank v. Radford, supra; Security-First National Bank of Los Angeles v. Rindge Land Company, 85 F (2d) 557, 32 ABR (NS) 97; Tennessee Publishing Co. v. American National Bank, supra; Horn v. Ross Island Sand and Gravel Company, (C. C. A. 9) 88 F (2d) 64, 33 ABR (NS) 463; In re 333 Michigan Avenue Bldg. Corp., (C. C. A. 7) 84 F (2d) 936, 31 ABR (NS) 639. But, as pointed out in the Radford case, a different principle applies where, as in the case at bar, there is a class of lien holders, and where the objectors are only two out of many lien holders of the same class. In such a situation, there may be a scaling down of the secured debt by way of reduction of interest, reduction of principal, extension of the maturity date, or any other of several devices, provided two-thirds, in amount, of the class consent, and provided further that the plan is fair, equitable, feasible and not discriminatory as to any member of the particular class. The case of Horn v. Ross Island Sand and Gravel Company, supra, is not authority against this proposition. Our own Circuit Court indicated clearly that in that particular case there was no such consideration passing from the stockholders to the enterprise, as would have made the final plan a proper one under the law. The case is therefore easily distinguishable.

The second point of objectors is that no stock in the reorganized corporation can be given stockholders upon any basis at all, since the debtor corporation is insolvent. Objectors rely upon expressions, appearing in a number of cases, to the effect that creditors must first be made

"whole". In the case of In re New York Railways Corp., 82 F (2d) 739, 30 ABR (NS) 748, Judge Manton, in the Second Circuit, said:

"The courts will scrutinize with care all plans of reorganization proposed for insolvent companies to make certain that assets belonging to creditors are not by indirection being diverted to stockholders, but it is obvious here that no such purpose is shown. Stock equity may not be allowed to participate in any plan of reorganization which does not first provide for making creditors whole." Just what that expression means is not clear. Does it imply payment of the principal and accrued and unpaid interest in full,—in cash immediately on the line? Or does it mean something less than that? Counsel for the objectors has suggested that it means giving the creditors "complete compensation", and it may be that Judge Manton actually meant, by the word "whole", "properly or fairly compensated". That was the meaning expressed in Northern Pacific Ry. v. Boyd, 228 U. S. 482; 33 S. Ct. 554; 57 L. Ed. 931. It is probably more nearly a correct indication, and that terminology has been followed by many courts. It is true, as suggested by counsel, that creditor lien holders must be fairly compensated before old stockholders may be let into the picture; for which point the Rindge case, supra, is authority. However, the District Court does have wide discretion in determining whether or no there has been fair compensation provided under the plan (In re Georgian Hotel Co., supra).

In the reorganization of weak enterprises, where it is desirable to clear away all bonded indebtedness so as to facilitate the raising of new capital, shares of stock certainly may be issued for all outstanding bonds. That has been done many times. In such cases it is usual to wipe

out the interests of the old stockholders, or to scale down their holdings drastically, or even to compel them to pay an assessment in order to retain any interest in the project. Gerdes on Corp. Reorganizations, p. 1643, Sec. 1026; Ginty v. Ocean Shore Ry. Co., 172 Cal. 31, 45; In re Caffall Oil Corp. (D. C. La.), 22 F. Supp. 484. While a fair plan must give due recognition to the interests of all classes of creditors and stockholders, this does not mean that recognition may only be given by cash payments, in part or in full. Gerdes on Corp. Reorganization, p. 1741, Sec. 1086.

As pointed out by the Supreme Court in the case of Kansas City Terminal Ry. Co. v. Central Union Tr. Co., 271 U. S. 445, at 454, in discussing the effect of the Boyd case,

". . . This does not require the impossible and make it necessary always to pay unsecured creditors in cash before stockholders may retain any interest whatever in the reorganized company. By way of illustration it (the Supreme Court in the Boyd case) further pointed out that such creditors can be protected 'by the issuance, on equitable terms, of income bonds or preferred stock.' And we now add that, when necessary, they may be protected through other arrangements which distinctly recognize their equitable right to be preferred to stockholders against the full value of all property belonging to the debtor corporation, and afford each of them fair opportunity, measured by the existing circumstances, to avail himself of this right."

The District Court must scrutinize reorganization plans of insolvent companies in order to be sure that assets be-

longing to creditors are not by indirection diverted to stockholders. (In re Day & Meyer, 93 F (2d) 657, 35 ABR (NS) 440; Price v. Spokane Silver & Lead Co. (C. C. A. 8) 97 F (2d) 237, CCHS 5119) or to the debtor corporation itself. (Horn v. Ross Island Sand & Gravel Co., supra.) We do not feel however that this means that old stockholders cannot be provided for in the reorganization, where they do furnish to the creditors compensating advantages.

In the case of In re Day & Meyer, just alluded to, one of the latest cases on the subject, it appeared that there was in the property a substantial equity over the bonded indebtedness. The plan however provided that the bonds be reduced to one-half their principal amount; that past due interest thereon be eliminated, and that the equity created by such scaling down be represented by the issuance of new preferred and common stock to be shared by bondholders with general creditors, old stockholders and existing management. The appellate court disapproved this plan because it did not preserve priorities and deprived bondholders of their lien without any compensating advantages.

In the case of Horn v. Ross Island Sand & Gravel Co., supra, it appeared that the bonded indebtedness covered five parcels of property, three of which were land, the fourth buildings and equipment upon the lands, and the fifth, shares of stock in two corporations. It also appeared that the shares of stock of one of the corporations were turned into cash during the proceeding. The Plan of Reorganization provided for the distribution among the bondholders, on a pro rata basis, of the cash thus realized from the sale of stock, but that all the other items of property were to be turned back to the debtor, free

of the bond lien. While the plan was actually approved by the requisite majorities of bondholders, unsecured creditors and stockholders, the appellate court held that there were no compensating advantages at all furnished by the debtor to the bondholders. The court expressly found that there was no consideration passing. It did not even say that it was not adequate. It rejected the plan, and pointed out:

"In Security-First National Bank of Los Angeles v. Rindge, 32 ABR (NS) 97, 104, 85 F (2) 557, 561, we said: 'There is nothing in Section 77-B which authorizes a debtor to pay a secured creditor less than half the amount of the debt while retaining to its own use a portion of the property securing the debt. The right to retain a lien until the debt secured thereby is paid is a substantive property right which may not be taken from the creditor consistently with the Fifth and Fourteenth Amendment to the Constitution.'"

Our Circuit Court also referred to the decision of the Seventh Circuit, In re 333 North Michigan Avenue Bldg. Corp., supra, where Judge Sparks had said:

"Under Sec. 77-B, the rights of all claimants and creditors are entitled to the same protection, but they may be divided into classes, as was done in this proceeding. That law requires a two-thirds vote of each class before a plan can be confirmed, and that provision was complied with in the case before us. When a class consists of only one party, regardless of the nature of his claim his consent must be obtained, provided his claim is affected by the plan. If, however, he is one of a class, and two-thirds of that class approve a plan which the court finds fair, equitable, feasible, and not unfairly discriminatory in favor of any class, and all classes have so consented, the re-

maining members of that class or classes will be bound by the plan, although their rights may be changed," Citing Continental Illinois etc. v. Rock Island Railroad, supra; Louisville Joint Stock Land Bank v. Radford, supra; and Cumberland Glass Manufacturing Company v. DeWitt, 237 U. S. 447, 34 ABR 723, 35 S. Ct. 636, 59 L. ed. 1042.

Summing up the law on this point, Judge Augustus N. Hand stated, in the case of In re Barclay Park Corp., 90 F (2d) 595, 34 ABR (NS) 209:

"To justify a retention of a stock interest by the present shareholders it should appear that they have furnished an additional consideration or have an equity in the estate of the debtor after the rights of the creditors are fully provided for in some way."

The court has a wide discretion with respect to allowing stockholders to participate in the plan, even though the debtor is insolvent. In re Georgian Hotel Corp., supra; In re Baldwin Locomotive Works, (D. C. Penn. 1937) 32 ABR (NS) 669, 21 F. Supp. 94; In re Burns Bros., 14 F. Supp. 910, 35 ABR (NS) 714; In re A. C. Hotel Co., (C. C. A. 7) 93 F (2) 841, 35 ABR (NS) 555.

In the Burns case the debtor was insolvent but there were counterclaims, substantial but controverted, asserted by the debtor against creditors holding ninety-five percent of the unsecured claims. A reorganization plan by which the claims of these creditors were subordinated to the claims of other creditors was held fair, the plan having

been approved by a large majority of each class of creditors and stockholders. The court went on to say:

"On the foregoing facts, it is evident that the present plan and the two motions incident to it represent an effort to compromise controversies among creditors and stockholders of the debtor and to relieve the debtor of its financial embarrassments by a prompt reorganization."

Judge Evans, in the A. C. Hotel Co. case, supra, likewise pointed out:

"The expressed preference of a large percentage of all classes of security holders interested in the property, especially if well considered and apparently intelligently reached, should not be lightly set aside. Proceedings under Section 77-B are for the benefit of security holders, particularly the creditors, if the debtor be insolvent. It is their property rights that are at stake. In ventures where large sums of money are borrowed and bonds sold to the public there is difficulty in getting united, intelligent action on the part of widely scattered bondholders, many of whom are holders of but a few bonds. The Bankruptcy Law was amended to meet such a situation and to permit of effective action where two-thirds of the creditors of each class of claims favor it."

This point settled by sound authority, we come naturally to an examination of what consideration, other than cash, the Class A stockholders in the case at bar propose to give up or surrender, or have already given up, as a justification for the issuance of stock to them under the plan, and what benefits the bondholders will derive under that plan. The following factors have been urged as being pertinent:—

(1) At the time of the 1930 reorganization the book assets were worth only about $400,000.00, and, if the

bonds had been foreclosed at that time, that is all the bondholders would have received. They would have taken that sum and stepped out of the picture, recovering thereby only a small part of their original investment. At that time those stockholders who are now given consideration in the plan of reorganization, advanced $400,000.00 in cash upon the agreement that foreclosure proceedings under the Trust Indenture would not be initiated by bondholders unless interest was earned and not paid.

(2) The old stockholders are the only persons who are familiar with the company's operations and who have had experience in shipbuilding. Their accumulated experience is of value to the reorganized company. Among their number are individuals who not only have been active in past management but who now have business contacts which will be of value *of* the reorganized company, these contacts being with financial institutions and with oil companies who now constitute the debtor's principal customers. They have expressed a willingness to assume managerial responsibility.

(3) Most of the present bondholders are widely scattered with small holdings, and their position would be benefitted by being associated with old stockholders of financial influence and stability who might be able to assist in proper financing.

(4) If the plan of reorganization is not confirmed, bondholders will have to wait, in all probability, until 1944, in order to realize upon their security. If the bondholders, through this 77-B proceeding, attempt to eliminate the stockholders, the latter may make strenuous objection upon the theory that, unless they are given some consideration, the proceedings are tantamount to a foreclosure, and therefore violate the previous agreement so

deferring foreclosure. This might easily result in litigation which would not only be expensive but which might delay matters so that present opportunities would be lost. In waiving their right to defer any possible foreclosure, these stockholders who are given consideration under the plan are clearly parting with a valuable asset. We are not in sympathy with objectors' contention that the agreement to defer foreclosure was illegal and ineffectual.

As previously stated, this deferment of foreclosure was accomplished through compliance with the provisions of Article IX, Section 2 of the Trust Indenture, which provided, in effect, that three-fourths in amount of bonds could bind all the bonds in perfecting an amendment, even to the extent of impairing the lien. In the opinion of this court, such a provision is valid, provided, of course, the modification is fair and equitable. Here it will be noted the bonds themselves contain on their face, a reference to the terms of the Trust Indenture and the right to amend contained therein.

Sneath v. The Valley Gold, Ltd., 68 Law Times Reports (NS) 602.

In re Georgian Hotel, Corp., supra.

In re British Columbia Portland Cement Co., 22 Dominion Law Reports 609, affirmed by the British Columbia Circuit Court of Appeals, 1916, 27 Dominion Law Reports 726.

Dolph v. Cincinnati B and C R Co., 103 N. E. 13 (1913).

Mercantile Inv. & Gen. Trust Co. v. International Company of New Mexico, 7 Times Law Reports 616.

British American Nickel Corp., Ltd. v. O'Brien, Appeal Cases (1927) 369.

If the proposed plan is not confirmed, and the present proceedings dismissed, the bondholders will be in a quandary. They cannot foreclose before 1944 without litigation, which promises to be long and expensive. In the meantime, the company may die of dry rot, because of its inability to take advantage of current opportunities and to participate in the expected revival of ship construction. Even if the contesting bondholders could have declared illegal the agreement deferring foreclosure until 1944, they would still be faced with that provision in the Trust Indenture which requires the consent or direction of twenty-five per cent, in amount, of bonds outstanding before a sale by the trustees may take place. Naturally, it would be impossible to get the consent of twenty-five per cent of those holding bonds because more than seventy-five per cent are definitely opposed to such a procedure and have so declared themselves.

All the bondholders who are in favor of some fair and equitable plan of reorganization seem to agree that the division of stock in the reorganized corporation, between bondholders and old Class A stockholders, is proper upon the basis of seventy-seven and twenty-three per cent. respectively. The only objectors, apparently, are the dissenting bondholders,—holding $18,500.00 face value of bonds,—who want to be paid off in full, and who are opposed to bondholders who deposited under the 1930 reorganization and stockholders getting anything until they are so paid. There does not seem to be any difference of opinion among those bondholders who believe the stockholders should have participation. If they are to participate at all, the indicated percentages are satisfactory. Whether or not this court might feel that the stockholders' participation is too large, too small, or just right, is not now important. After all, that matter has

been pretty well threshed out by all the interested parties over a period of many months. Apparently all but a comparatively few bondholders have expressly conceded, and the special master has held, that there is now an equitable and fair division proposed. This court's problem therefore is simply this: May the old stockholders be allowed anything?

In the case of In re Baldwin Locomotive Works, supra, the court held that while the creditors have a prior right to payment of their claims before stockholders get anything, still, on the question of whether a reorganization plan may be wise or foolish, the court, in its exercise of its power of approval, should defer to the business judgment of those whose financial interests are at stake. This court is in accord with that statement.

It is next contended by objectors that the plan of reorganization should be disregarded and a liquidation had under subdivision (k) of Section 77-B, after the entry of an order of liquidation. It is doubtful whether this court has power to liquidate the assets covered by the Trust Indenture, either under subdivision (k) or in a separate bankruptcy proceeding, since there is clearly no equity in the property above the amount due on the bonds. The decisions are not entirely clear, but the principle seems sound, and judges are properly loath to provide for such a liquidation without the consent of one hundred percent. of the lien creditors. The sale, of course, would have to be "free of liens",—i. e., the bondholders' lien would have to be wiped out and their interests satisfied out of the proceeds of sale. While the bankruptcy court has power to sell free and clear of liens, Van Huffel v. Harkelrode, 284 U. S. 225, 76 L. Ed. 256, 52 S. Ct. 115, 18 ABR (NS) 730, it seems to be settled that such

a sale will not ordinarily be ordered where the amount of the incumbrance exceeds the value of the property as found by the court. After all, the question of whether or no such a sale, free and clear of liens, should be ordered, is, also, one for the sound discretion of the court, in the light of all the circumstances (Central States Life Ins. Co. v. Koplar, (C. C. A. 8) 80 F (2d) 754, 30 ABR (NS) 236; Federal Land Bank of Baltimore v. Kurtz, (C. C. A. 4) 70 F (2d) 46, 25 ABR (NS) 63. See, also, In re Miller (C. C. A. 7) 95 F (2d) 441, 36 ABR (NS) 361). That discretion will ordinarily not be exercised unless all lien holders have consented, or have not objected after having been given reasonable opportunity so to do. (Horn v. Ross Island Sand & Gravel Co., supra; In re Zehner, 193 Fed. 787, 27 ABR 536.

The Ninth Circuit decisions in Security-First National Bank v. Rindge Land Etc. Co., supra, and in Francisco Bldg. Corp. v. Battson, 83 F (2d) 93, 31 ABR (NS) 180, are distinguishable in that these cases deal with instances under subdivision b-(5) of Section 77-B. There less than two-thirds in amount consented to the plan and our Circuit Court has held that, in that event the protection afforded to non-assentors must be completely compensatory. In the case at bar, considerably more than two-thirds have expressly consented; and only $18,500.00 in face amount out of $2,565,500.00 outstanding have actually objected. It has naturally been found impossible to communicate with many of the other bondholders.

A brief examination of some of the cases cited by counsel for the objectors (In re Day & Meyer, supra, and Preble Corp. v. Wentworth, (C. C. A. 1) 83 F (2d) 73, 31 ABR (NS) 453) will reveal that these cases are also distinguishable, in that, in the case at bar, stockholders

are giving up substantial and valuable rights in exchange for their common stock, and are providing a continuity of experienced management. See In re Barclay Park Corp., supra. The case of Texas Hotel Security Company v. Waco Development Co., 87 F (2d) 395, 32 ABR (NS) 335, may also be distinguished because here we have the consent of some ninety-two-odd per cent., of the class which is being affected. In Wayne U. S. Glass Co. v. Owens Ill. Glass Co., 91 F (2d) 827, 34 ABR (NS) 262, the proposed plan gave stockholders control, while in the case at bar bondholders have a very substantial control through the division of seventy-seven as against twenty-three per cent.

There seems to be nothing in the case of In re New York Railways Corp., 82 F (2d) 739, 30 ABR (NS) 748, or in Northern Pacific Ry Co. v. Boyd, 228 U. S. 482, which in theory interferes with the adoption of the plan here proposed. The former bondholders are here given each year a preference in dividends and are at all times preferred up to the par value of their shares upon liquidation; which is, of course, a most substantial right. Under it the common stockholders will receive nothing, if there is a liquidation in the near future, until the preferred stockholders have received the par value of their stock.

There are other points raised by counsel for the objectors, such as—that the plan is not fair and equitable in that it removes the lien of the bonds and gives bondholders merely a stock interest in the enterprise; that it does not make any allowance for unpaid interest; and that it is based upon an inadequate appraisal, in that it does not take into consideration the very valuable Harbor Lease.

We do not deem it material how the bondholders' claim arises; whether from failure to pay principal or interest, or both. The aggregate is what we are interested in. Nor do we feel that the loss of the lien is fatal. Under the modified plan, since the bondholders are given a very substantial majority of the new stock, they at all times will control the new corporation by having the legal capacity to elect a majority of the board, and may even liquidate the corporation. Actually the bondholders are being given practically everything they could get after they had gone through the trouble, expense and delay incident to foreclosure—even if a foreclosure could be had in spite of the moratorium agreement. The exception is this: they are possibly foregoing a 23/100ths interest in the business in consideration of an immediate reorganization. We say "possibly" because of the preference given to preferred stockholders upon liquidation, which may give them all the assets instead of 77/100ths thereof. Bondholders apparently believe that a bird in the hand is worth two in the bush; that a seventy-seven percent. preferential interest in the profits of a growing business may pull them out entirely, and that an immediate forced liquidation might bring them very little return. The court does not regard the Harbor Lease as of any value, unless some way is provided to make debtor a going concern; otherwise, there is no way to realize any substantial value from that lease. There is no evidence that the lessors would be willing to pay a bonus to be released from it, or that the lessee can get any advantage from transferring it. The court accordingly finds, as a matter of fact, that except to a going concern, the lease has no substantial value.

It is also argued by objectors that, by reason of the deposit of bonds in 1930, depositing bondholders lost their

liens because the deposit agreement transferred all right, title and interest in the bonds to the bondholders' committee. A reading of the deposit agreement convinces the court that the deposit and transfer of title was for a special purpose, that the bondholders retained equitable rights therein including the right to a return of the bonds when the purpose of the deposit was complied with. By that process there could have been no merger of title in the company, as claimed, which would have tended to destroy the lien of the bondholders against the property.

It is likewise urged that the provisions of the original Trust Indenture, if literally interpreted, preclude debtor corporation from taking advantage of Section 77-B as against the bondholders or, at least, as against objecting bondholders. This argument rests on the theory that if the moratorium against foreclosure prevented the bondholders from foreclosing through a trustee's sale or by a judicial sale, it also precluded any possible liquidation under the provisions of Subdivision "k" of Section 77-B of the Bankruptcy Act. It seems to the court extremely doubtful that in any event such a limitation could be made to apply to involuntary proceedings under Section 77-B, commenced by creditors against the debtor as provided in subdivision (a) of that section; and any such attempted restriction upon the debtor's rights even in a voluntary proceeding would seem to this court to be void, as contrary to public policy. The court does not believe that the company could place itself, or that the bondholders did place themselves by this agreement which is binding upon all parties, in such a position that advantage could not be

taken of this section of the Bankruptcy Act, In that connection see:

In re Weitzen, 23 ABR (NS) 653, 3 F. Sup. 698;

Federal National Bank v. Koppel, 6 ABR (NS) 287, 253 Mass. 157, 148 N. E. 379.

It has been held in a number of cases that a state or federal court appointing an equity receiver for a corporation cannot lawfully restrain its officers from invoking bankruptcy or consenting thereto. This principle seems sound and analogous.

Struthers Furnace Co. v. Grant, (C. C. A. 6) 30 F (2d) 576, 13 ABR (NS) 537.

In re American & British Mfg. Corp., 300 Fed. 839 4 ABR (NS) 1041.

The court has so far been talking principally to attorneys here involved, who, through years of training and experience, are familiar with the many technical difficulties encountered in matters of this kind. But there are many bondholders before the court who have taken a constant interest in this matter, as have likewise some of the old Class A stockholders. The court would like to talk briefly to these laymen, who are, after all, the parties most directly interested. While all have consented to the plan, many have not been actively represented by counsel at the hearings and hence have had no one to explain to them, in simple terms, the complexities with which we have dealt in this opinion. The court would like to explain the difficulties which we are encountering in plain, every-day English, and will be pleased to answer any questions either in open court or in chambers.

We all know that the debtor has placed itself under the jurisdiction of the Federal Bankruptcy Court. What does that mean? It seems that the debtor cannot pay its debts; it comes into court admitting its insolvency, and asking the court to spread its protective mantle over debtor so that its remaining assets may not be unfairly dissipated or distributed.

We are in this position: We have to deal with the situation as we find it today. We cannot go back to the time when this corporation was organized,—with its hopes and aspirations,—nor to the time when the particular debts here involved were created. When you good people invested your money in the bonds of this corporation, you were probably investing your savings, just to obtain a little income. You had no intention of buying any profit-participating interest in the business of the Los Angeles Lumber Products Company with its accompanying risks. Now, unfortunately—and without any fault on your part—the assets of the corporaation have greatly depreciated in value. Likewise, due to unexpected circumstances, business has been unsuccessful, so that operations which previously resulted in a profit now either result in no profit or in a substantial loss. Of course, that is most distressing. Yet, in all fairness, no one seems to have charged the managing officers of debtor corporation with neglect or bad faith or wrongdoing. These officers have apparently done everything within their power to save the situation, but have been unsuccessful. You are just the victims of another of those combinations of circumstances with which everyone has become familiar during the last two to five years.

In spite of, literally, months of earnest and intelligent effort, it has been found impossible to get the written con-

sent of one hundred percent. of the bondholders and stockholders to any plan of reorganization. Because of this, debtor corporation has placed itself under the jurisdiction of this federal bankruptcy court. The Act under which it crept, as you know, is Section 77-B, which is a comparatively new amendment to the Bankruptcy Act. This bankruptcy court is a court of equity, and, realizing that debtor's assets are not now capable of being liquidated so as to realize any substantial amount for bondholders, we have been attempting to work out some plan which would result in the greatest benefit to bondholders. The court has no particular interest in stockholders, except to use them, in what seems the best possible way, for the interest of bondholders. That is perfectly proper. After all, if the bondholders cannot be paid in full, they are the ones who are entitled to our primary consideration. Accordingly, the court does not propose to give stockholders any more than is necessary in order to accomplish a desired result. The evidence seems to show to the court that, even under the most favorable circumstances, a present sale of the assets and the distribution of the net proceeds among the bondholders would not give them a net return of more than—at the outside—two hundred dollars on a thousand-dollar bond, including accrued and unpaid interest. As a matter of fact, it is doubtful whether, with forced liquidation under existing conditions, the bondholders would realize more than a hundred dollars a bond.

The court recently received a letter from one poor woman who owned a thousand-dollar bond. In that letter she said, "Judge, I don't want any stock. I want my money." The court wishes she could get it. It doesn't blame her a bit for wanting it, but there is no way in the world that this court can liquidate those assets so that she and others similarly situated can get their money.

This situation is most discouraging but, unfortunately, there is nothing the court can do about it. We have to take things as we find them. But you may be sure that the court is most sympathetic. We all know from past experience,—very sad experience,—just how hard it is to face substantial losses in investments. Yet one cannot get blood out of a turnip. There is just so much available in assets, and we must handle those assets in such a way as to do the best we can for the bondholders. Let us meet the situation fairly and squarely and not fool ourselves. Remember, we are dealing with existing conditions, and not with past hopes or past prospects. We are here to do the best we can, under the circumstances as we now find them. As the court sees it, there are only four things that we may do properly under existing law.

The first thing that we could consider doing would be to reject this plan and dismiss the proceeding.

The second thing would be to reject the plan, but not dismiss the proceeding. The court might then keep the case in this court and possibly order liquidation and sale of the property through Subdivision (k) of Section 77-B, to which reference has been made previously, or under its general equity powers.

Or, third, the plan could be rejected but the corporation notified of the court's intention to dismiss the proceeding, so that debtor would have time to file a voluntary petition in bankruptcy, under which there could be a liquidation through the normal processes of the bankruptcy court.

The fourth choice would be to approve the plan before the court. Unfortunately, we cannot permit the corporation to go along in the same way as it did prior to the filing of this proceeding. The officers and directors refuse to continue under such an arrangement, because they feel

they cannot function efficiently with any hope of business success. They have no way to finance jobs; because they cannot convince people who are interested in shipbuilding contracts that they are financially in a position to meet their commitments. They have indicated their hopelessness in this existing situation by filing this petition. So we really have no choice in that direction.

'Let the court tell you bondholders what might happen under each of the three other possible methods of handling this situation, if it should refuse to approve the plan. Let us take the first method suggested, that is, rejecting the plan and dismissing the proceeding. Under that choice the corporation would be put out of court, and would not be given any right to relief under Section 77-B of the Bankruptcy Act. The corporation would have to discard the protective mantle of this court and let matters take their course. That sounds very simple, and it would relieve this court of a lot of worry, but what about the poor bondholders? Theoretically, they would have a right immediately to start foreclosure under the terms of the Trust Indenture. This could—also theoretically—be done either by a sale through the trustee or by a sale through other judicial proceedings which are authorized by law and the Trust Indenture. However, this is not so simple as it sounds. Why? Because, in a prior reorganization, and apparently strictly in accordance with the provisions of the original Trust Indenture, the holders of more than seventy-five per cent. in principal amount of the bonds, agreed to a foreclosure moratorium until 1944. The court has already explained that it believes that provision to be valid. But, even *it if* were not valid so as to bind those bondholders who did not assent to the moratorium, the bondholders are still not much better off,—because twenty-five per cent. in amount of the bonds cannot be obtained,

as required by the Trust Indenture, in order to force a foreclosure through the trustee. If any other type of proceeding, such as a judicial sale, were attempted, naturally the stockholders would endeavor to restrain the proceeding in accordance with the terms of the moratorium agreement, which would at least result in great expense and delay. The ultimate result would then be unsatisfactory to all interests.

Now, let us take the second choice; that is, the rejection of the plan and liquidation under Subdivision (k) of the Act. The court has already explained the legal difficulties incident to such an attempted liquidation. Under the circumstances, this court believes that such a liquidation, even if legally possible, would be impractical, would delay proceedings, and would be very expensive. The stockholders would undoubtedly litigate the right of debtor so to act, in face of the moratorium agreement, which would add to the expense and delay.

The third possibility is a dismissal of the proceedings, permitting the corporation to go into bankruptcy in the regular way, and be liquidated. All the objections to the second choice are certainly equally pertinent under this method. This would also involve the appointment of a new trustee, etc., which would be expensive and unsatisfactory, and the net results of which might be pitifully small.

Our only hope seems to be to work out some plan whereby the corporation can go ahead and try to take advantage of immediate shipbuilding possibilities. The court believes that any normal bondholder would rather take his chances that these experienced officers can salvage some of his loss, than to let the corporation be put through forced liquidation. Wouldn't he prefer to give them a

chance to make a success, and ultimately pay him back some substantial percentage of his investment? Wouldn't he feel that this is an unsatisfactory time for a forced sale and that getting a few immediate dollars would be too great a price to pay—considering the favorable possibilities of the future? Wouldn't any such bondholder feel that, with the recovery program now initiated by the Government whereby shipbuilding is to be encouraged, it would be sensible to put this corporation in shape to take advantage of its opportunities? Two or three profitable contracts might conceivably save a large part of the investment.

To make a long story short, he would rather take half a loaf than no bread. If values, on liquidation, are pretty close to the minimum, why not take the chance of possibly sacrificing this 23/100ths per cent. of the present liquidating value of the property against the livelihood of a successful operation? We say "possibly sacrificing" a part of the liquidating value because, under the preference arrangement of the new Class A stock, the bondholders—who get that stock—must be paid in full before the new Class B stockholders—who are the old Class A stockholders—get anything. Now, if there isn't a successful operation in the future the bondholders control this corporation, and they can put it through liquidation themselves in a much less expensive manner than can the bankruptcy court. They can elect directors who will order a sale of the properties, and if there is then a better market for this type of property, that might somewhat offset any sacrifice due to delay. Of course, if, as is anticipated by

the managing officers, they can make a success of the undertaking, there is the possibility of a very substantial recovery for the bondholders. The bondholders apparently feel that this is the situation, or such an unusually large percentage of them would not have consented to the program.

The court is familiar with the usual proposals in these cases—to pay off in full the non-assenting, or at least the objecting, bondholders and get rid of them. It does not approve of any such proposal. It sees no reason why any portion of the money available for bondholders should be diverted to pay off any particular bondholders. Every one here will, I believe, agree with that principle. It is, of course, true that a court of equity will not allow minority bondholders to be disregarded, or unfairly treated, in a reorganization plan, yet, on the other hand, it will not lend its aid to a claim by a minority bondholder which may result in holding up a fair reorganization plan, solely as a means of obtaining greater value or more favorable returns for that minority bondholder than are offered to all the other bondholders.

I want it definitely understood that this court does not believe that Mr. Case and the other objector are in here with the deliberate idea of holding up this proceeding, in order to shake down the rest of you, and compel you to pay them off. In fact, I would state, from my knowledge of men, that this is not the case. However, it is unfortunate that the effect is just exactly the same as though they were doing that very thing. That is, the legal effect of it is exactly the same, and this court be-

lieves that it was to avoid just such abuses that Section 77-B was placed on the statute books by Congress.

There is one other element here that has had some influence upon the court in reaching its conclusion. It is necessary to act promptly if an attempt is to be made to put this corporation back on its feet as a going concern. To dilly-dally around over a period of many weeks or months would almost certainly result in heavy losses to the bondholders. It was for that reason, while occupied with the trial of other matters, that this court appointed a Special Master and for that reason that the court has kept such careful track of each step in this proceeding from beginning to end. If we are going to do anything, let us get at it at once. Let's not stretch it out over a period of years until everyone's patience, and most of his money, is exhausted.

There has been a request by the proponents of the plan and others that the services of the Special Master be continued in order that the consummation of the plan might be expedited. The court is in accord with that, and it is so ordered.

The court sees presently no reason for ninety days in which to elect a board of directors. Everyone is counseled to get right at this matter and have it move along promptly. Even in the face of an appeal from the decision of this court,—which is, of course, perfectly proper, and perfectly within the rights of those who oppose the plan,—there should be action toward culmination of the plan. The court, in any event, will continue its jurisdiction. The

order of the court permitting the debtor to remain in possession will be continued until further order. The court finds that the plan now proposed by debtor herein has been duly and properly presented, considered and approved by more than the required amount of each class of creditors and stockholders, strictly in accordance with the provisions of Section 77-B of the Bankruptcy Act, and that no other plan for the reorganization of debtor, or any amendment to said plan or modification thereof, except as herein expressly indicated has been proposed; that all proper notices have been given to all interested parties, as required by law; that all proceedings taken by debtor in connection herewith and by its Board of Directors, officers, attorneys and agents in the preparation and submission of said plan and for its approval and confirmation have been done in good faith; that the plan is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders of the debtor, and is feasible; that the plan complies with the provisions of Subdivision (b) of Section 77-B and all other applicable provisions of Section 77-B; that the plan has been accepted, as required by the provisions of Subdivision (e), Clause 1 of Section 77-B, and all other applicable provisions of said Section 77-B; and that the offer of the plan and its acceptance are in good faith and have not been made or secured by any means or promises forbidden by the Bankruptcy Act.

The court hereby expressly rejects and overrules all objections to the plan of reorganization and objections to the order of this Court classifying creditors and stock-

holders of debtor into classes, according to the nature of their respective claims and interests, and objections to the jurisdiction of the court and exceptions to the Special Master's report.

The court expressly reserves jurisdiction of these proceedings to make such further orders and to take such further action in connection therewith as to the court may seem meet.

Exceptions are allowed to all rulings of the court.

Counsel for the debtor is directed to prepare findings of fact and conclusions of law and a form of decree, which will embody, in as far as the same are necessary, the statements of the court made here today. The form of order will then be submitted to all interested counsel, to the Master, and to the court for final approval.

It is so ordered.

Ralph E Jenney
RALPH E. JENNEY
United States District Judge

DATED: July 18, 1938.

[Endorsed]: Filed R. S. Zimmerman, Clerk at 6 min. past 9 o'clock, Aug 6, 1938 A. M. By L. B. Figg, Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

APPELLANTS' AMENDED STATEMENT OF EVIDENCE AND PROCEEDINGS, ON HEARING OF PROPOSED PLAN OF REORGANIZATION, FILED UNDER SECTION 77B. OF THE BANKRUPTCY ACT.

The above entitled cause came on regularly for trial before Hon. Reuben G. Hunt, Special Master to whom the matter had been regularly referred by the District Court. Thereupon the following proceedings were had:

– I –

Among the records and pleadings considered by the Special Master were:

The Petition of the Debtor with its Proposed Plan of Reorganization under Section 77B. of the Bankruptcy Act, filed Jan. 28, 1938, and the Order of Court approving the said Petition as properly filed under Section 77B., continuing Debtor in possession and control of its properties, pending a hearing on said Petition, providing for the time and place of said hearing and the parties to whom and the manner in which notice of hearing should be given:

The Proposed Modification of the Plan of Reorganization, filed March 18th, 1938;

The Trust INDENTURE of Los Angeles Lumber Products Company and of Los Angeles Shipbuilding and Dry Dock Corporation, as Debtor's Exhibit E., securing the bond issue involved in this cause;

The Answer to Petition and Contravention by Thomas K. Case, a secured creditor, filed March 8th, 1938;

The Addition and Amendment to Answer of Thomas K. Case, dissenting, Secured Creditor, filed March 16th, 1938.

On March 11, 1938, Thomas K. Case, a dissenting secured creditor, duly sworn, testified as follows:

I own and possess and have possessed for many years thirteen $1,000.00 bonds and one $500.00 bond of the Los Angeles Lumber Products Company, 7½% 20-yr. sinking fund gold bonds. They have always been in my possession since they were purchased. The numbers of those bonds are given in the original claim which I have filed here, and they are M1428, M1586, M1647, M1830, M1838, M624, M1942, M2512, M2513, M469, M579, M2362, M2431 and D145. The major part of those bonds were purchased by me on December 6, 1924. Later on a small number were purchased on October 2, 1928, and the last small portion on March 19, 1929. I will say that I have never so far as I recollect, and I am quite positive of it, signed any document consenting to any of the proceedings that have been described. I paid par for $10,500.00 of those bonds, really 99½; as an investor one-half of one point was allowed to me, practically par. For the balance of $3,500.00, 60% of par was paid.

I may be qualified as some kind of an expert too. I am testifying that the 230 shares offered for each $1,000.00 bond in this proposed plan, in my judgment, would have no market value and no value at all, no cash value at all. Owing to the fact that there has been a wide spread odium attached to the L. A. Lumber Products Company; part of that wide spread publicity arises under the investigation which the Sabbath Con-

gressional Committee has made and is making. That got a lot of newspaper publicity which hurt the Company. And there has been other publicity. Also, on the further fact that through the years I think I have had something to do with new corporations, and it is very difficult and practically impossible to sell to the public shares of a newly organized company, and especially where it is a reorganized company, as this will have been if it goes through, under Section 77B. I do not believe you could get a business man or any individual engaged in business down town who would pay a dollar for that stock.

I cannot picture the plan being approved as it is now, to be frank with you, in the final determination. Counsel (Mr. Faries) has taken the position, and he is thinking clearly, that there is a difference here as to the assets so far as the L. A. Shipbuilding Company is concerned, and the L. A. Lumber Products Company is concerned. He has made the announcement that certain assets were not comprehended in the Trust Deed; that they belonged to the Shipbuilding Company. I do not want to say this critically if I can help it, but there must of necessity be a wide spread critical attitude toward the Company if reorganized and by reason of the publicity it has had. That hurts the sale of stock.

Then I would say as to that (as to possible assessments), still adhering to my qualifying opinion, that you could probably issue preferred stock and put it on top of the common stock that you are offering. You could put on a new bonded debt. In other words, the stock is down at the bottom and we have the same old situation over again. And, because of the tremendous publicity that the Company has received—

I will tell you the only information the public would get would be where some bondhouses sent out a statement with quotations on various dying securities, and there you will find the L. A. Lumber Products Company and some others. I say that that does not fix a value, a market value, and doesn't even establish the fact you could go and get the price therein quoted. I have seen that tried and you could not get the price quoted in those circulars. So I don't know how to fix a market value on anything in the shape this Company is in and the ill repute it is in.

You know what makes a market is sentiment. There is a sentiment toward a bond. In other words, the average man or woman has heard that a bond is a mortgage claim. In a general way, they have learned that it was a first mortgage and that it was superior to stock, that is capital stock. And they may have learned that it was superior to various issues of capital stock. There is a sentiment connected with a bond. But there is a sentiment in favor of a bond. I don't believe I could find a single individual who would pay cash for the L. A. Lumber Products Company shares of stock after the reorganization, if it was permitted on such a basis as is proposed. I am trying to qualify as an expert and say that there will be no market value to your stock.

It would not be necessary for them (bondholders) to buy it (the shipyard) if there was another concern perfectly willing to step in (in the event of foreclosure). Another thing, when your Company will make a fair estimate of the value of that leasehold interest, you have an asset there that might take you out of the insolvency position I think you are in. I will say that your assets, if sold, would pay this entire bond issue in my judg-

ment if it included your leasehold interest. You are carrying that (leasehold interest) on your books at one dollar. I would like to have it at that price.

It is worth half a million dollars at least.

C. F. Seidel, a member of the Bondholders Protective Committee, said to me today (eight years ago):

"Well, the lease of the harbor frontage, as you know, would have brought $2,250,000.00 a couple of years ago, and it looks as if another million ought easily to have come from the yards (lumber), but it is worth so much more than the $3,250,000. due on the outstanding bonds. As a going concern, Bethlehem Steel and other big shipbuilding concerns can't get it for nothing. It takes a man who understands the lumber business and the shipbuilding business, and they are very few. We think Mr. Armes, under the reorganization scheme, is that kind of a man. He has the proper background."

And my memorandum of Mr. Seidel's statement is further: "The Drydock, etc.," this he revealed, "would be of interest to Bethlehem." Seidel also said: "This is the last day for withdrawal by depositing bondholders. A few have withdrawn, only a few." I would like to show that memorandum to counsel.

I think that harbor frontage is worth a lot more today than it was when Seidel made that statement.

I did not have any definite understanding, but I knew it was not fair to me to place them (my bonds) with the Bondholders Protective Committee, because I did know as a matter of personal and professional experience that bondholders' protective committees are, and deliberately I say, always dominated by the stockholders. In other

words, it is a figment of deception. The Bondholders Protective Committee, in this case, Mr. Seidel, the Vice President of the bank, and the rest of them, were particularly individuals who should not have been on a bondholders' protective committee because they represented and were officers of the Trustee, the bank.

Mr. Faries announced that he was making no objection to this Exhibit, and it was marked "Dissenting Secured Creditor Case's Exhibit A".

By Special Master: Your claim is part of the record and the court will take judicial notice. Let the records show that, on March 8, 1938, Thomas K. Case filed in this proceeding his sworn proof of claim to the extent of $23,101.87 based upon the holding of bonds of the Debtor, a list of which is set forth in the claim.

In my judgment, the plan as proposed is neither fair nor feasible. It is not fair, I will say, to real honest-to-God bondholders, whose bonds can't be questioned, in so far as it would award capital shares of stock, and it is not feasible. And by "feasible" I impute a certain measure of reasonableness. And it is not fair to take the properties that are mortgaged and retain them and take away from the bondholders their lien and right to foreclose and other substantive rights. We allege here in our answer, and I am testifying on that, paragraph 5, on page 3 of the Answer, that 97% have sold and assigned all of their right, title and interest in those bonds; that the remaining portion of less than 3% is represented by the par value of approximately $56,000.00.

I mean undeposited bonds, yes. That that represented about 3% of the total issue, and that the rest of them were represented by the bonds which have been de-

posited. It is my belief that that is the sole purpose of this proceeding, or that the object of it is to get rid of the dissenting creditors represented by owners of bonds who have never deposited their bonds. In that connection I would offer what I have received in due course through the mail, a document entitled "Bondholders Protective Committee Agreement with the L. A. Lumber Products Company".

It starts on page 1 and it says in print: "This Agreement, made as of the 5th day of August 1929, between D. G. Sherwin, C. F. Seidel" and the rest of them.

Mr. Faries stated that he had no objection to this document being received in evidence, except that it is not binding upon the corporation itself. It was received in evidence and marked "Dissenting Secured Creditor Case's Exhibit B".

As a part of this Exhibit B, Intervening Secured Creditor Case's Exhibit B, on page 2, there is a short clause, Article 2, under the heading "Powers of Committee", as follows: "The depositors severally and respec-"tively do hereby assign and transfer to the Committee "the full legal, equitable and beneficial title to all bonds "deposited hereunder for all and singular the purposes "hereof, and severally and respectively agree that the "Committee shall be and it is hereby vested with every "right, power and authority of whatsoever character, "nature or purpose, in order to enable the Committee to "carry out and perform the purpose and intent of this "Agreement. The title to all deposited bonds shall vest "in the Committee immediately upon the deposit thereof "with the depositary," etc. I attract the court's attention to that particular portion of it that supports my conten-

ion which I have made a part of my Answer, as at least I think it does. On page 4 of my Answer, paragraph 9, I allege that "this creditor is informed and believes, and "on such information and belief alleges, that the Security-"First National Bank of Los Angeles, the Trustee named "in said Trust Indenture, acquired by purchase and, prior "to October 1935, owned outright between $700,000.00 "and $900,000.00 of par value of said bonds; that in the "year immediately preceding March 20, 1934, a portion of "said bonds, representing a par value of $87,500.00, were "purchased and owned by said corporation; that in the year "preceding, March 1935 said corporation had purchased "and owned a portion of said bonds, representing a par "value of $129,000.00, at an average price of six and "one-half cents for each one dollar par value." In that connection I offer, which you can look at again if you want to, these two printed circulars of Armes. I offer, if your Honor pleases, a printed circular issued by the Company, addressed to the stockholders of the L. A. Lumber Products Company, the printed signature being "Respectfully yours, Geo. A. Armes, President", it bearing date March 20, 1934, consisting of four pages, and listing assets and liabilities on the 2nd, 3rd and 4th pages, and, in support of the allegation in my Answer, I call the court's attention to this paragraph—

Mr. Faries: No objection.

The Master: It will be received as "Dissenting Secured Creditor Case's Exhibit C".

I received this document through the mail. I will read a short paragraph which is the 6th paragraph of this Exhibit C: "During the year 1933, the Company sold the "machinery and equipment of the shutdown properties, for

"which it received $9,089.62. This money is being used to "purchase outstanding bonds of the Company. In the "year just ended, bonds representing a par value of $87,- "500.00 were purchased. The average price paid for these "bonds was .064 cents for each one dollar par value."

It shows that the Company was buying these bonds at that time after the depreciation.

Just briefly on the same subject matter, about a year later, dated March 19, 1935, is another circular, bearing the printed signature of "Geo. A. Armes, President", showing the purchase of a much larger amount by the Company, at six and one-half cents for each one dollar par value. Reading from the document (Exhibit C of Dissenting Creditor):

"This money is being used to purchase outstanding bonds of the Company. In the year just ended, bonds representing a par value of $129,000.00 were purchased at an average price of six and one-half cents per each one dollar par value."

By the way, there is additional matter to this. There are other statements or admissions in there by the president as to the assets of the Company and the business that was transacted at that time.

Mr. Faries stated that there was no objection to offering this in evidence.

By the Master: It will be received in evidence as "Dissenting Creditor Case's Exhibit D".

By the Master: In other words, you contend that these (undeposited) bonds could be paid by the L. A.

Shipbuilding & Drydock Corporation out of its own funds?

A Out of its own funds, it and the L. A. Lumber Products Company. I don't separate them. They are not separable here. They are inseparable. I don't think, to be frank with you, and I have got some authority on it if it becomes material, that the Shipbuilding Company can get from under any more than the L. A. Lumber Products Company can get from under the obligations in the Trust Deed, whatever they may be in express terms, and that all of the properties of both companies are obligated.

I think the Company has the money to pay for the undeposited bonds. It easily could call those bonds and pay them at the call price. It is a going concern and has been making a profit in the last two months, January and February. The L. A. Shipbuilding Company is in every respect fully and completely and legally bound to pay these bonds, and to meet them and all their obligations. It is a wholly owned subsidiary. I contend that these bonds could be paid by the L. A. Shipbuilding & Drydock Company out of its own funds and those of the L. A. Lumber Products Company. They are not separable here. They are inseparable.

All unpaid interest coupons are attached to all of my $15,500.00 par value of bonds, and when making the purchases of these bonds I paid accrued interest up to the time of purchase of the bonds, in addition to the purchase prices testified to by me.

EARL COWAN,

a dissenting creditor, duly sworn, testified as follows:

"My wife, Adele B. Cowan, is the owner of five 1st Mortgage bonds of the Lumber Products Company. The numbers are M314, M318, M554, M553 and M1791. As near as I know, par value of $1.000.00 a bond was paid, with interest at 7% per annum, and payment was stopped in 1929. They were bought as a permanent investment."

The Master: All of the stock of the L. A. Shipbuilding & Drydock Corporation, the subsidiary, is owned by the L. A. Lumber Products Company, the Debtor here.

The proposition made to Mrs. Cowan as a bondholder for the exchange of her bonds for stock is 230 shares of stock for each $1,000.00 bond in the proposed plan.

Referring to the 230 shares of the capital stock of the proposed new company, from an investment standpoint I would say that that stock would have no market value. I don't thing that you could find anybody who would buy those 230 shares for each of your bonds and pay any cash consideration for that stock. I wouldn't want to recommend any friend of mine buying it at par. I don't think that the shares of stock would have value from an investment standpoint. I know what they are worth in my own mind.

(Testimony of C. C. Spicer)

C. C. SPICER,

duly sworn, testified as follows:

I am President of debtor corporation;

There were 57,000 odd shares of Class A stock issued by the corporation. Mr. H. K. Bagley is a member of the Board of Directors and is the agent and representative of Daniel Murphy, a large stockholder of the corporation.

All of the Class A stock was issued to the stockholders who put up the $400,000.00.

In addition to the 64,211 shares as the total issue of Class B stock there was also one share for each past due coupon on a $1,000.00 bond. The total number of shares of Class B stock was 6,421, which were issued to the bondholders who deposited, for unpaid interest on their bonds, and 64,211 shares were issued to Mr. Armes.

Approximately $56,000.00 represents the par value of the only outstanding and undeposited bonds, or something like that. The corporation is meeting all its current debts.

Q By Mr. Case: Is the corporation in a financial position to pay the par value, the premium and the unpaid interest on those bonds which have not been deposited?

A By Mr. Faries: The Los Angeles Lumber Products Company has no funds on hand with which to pay off that $66,000.00 in bonds or any portion of it. The Los Angeles Shipbuilding & Drydock Corporation has sufficient money on hand to pay them off if it were liable on them. It (Debtor) does not have the cash on hand to do that. It could, however, borrow sufficient money from its subsidiary, the Los Angeles Shipbuilding & Drydock Corporation, to pay them in full. That they could do despite the fact that they owe the Shipbuilding

Corporation almost $500,000.00. By reason of their control of it, they could undoubtedly borrow an additional amount from it and pay those bonds off if they were entitled to that preferred position, and if they were now due. In this particular case it is our position that, while the bond issue is owing and it is unpaid, both principal and interest, it is not due by reason of the terms of the supplemental Trust Indenture of 1930.

Mr. Case: If the undeposited bondholders are not affected or bound by the supplemental agreement of 1930, the obligation then is due to them. That is the logical corollary if they are the only creditors.

Mr. Faries: I will stipulate that is the logical corollary, but I say that they are bound by it and therefore their bonds are no more due than the others.

The Witness: The payment of $400,000.00 by the stockholders, in consideration for contributing that sum of money to the Company's treasury, required that they be released by certain individuals from a stockholders' liability. That payment was not merely a subscription to stock, but there was a written agreement prepared on the subject that the subscribers should be released from any claim for stockholders' liability. These stockholders would not, I know as President of the corporation, have taken the 57,000 shares of a newly created class A stock without the release of stockholders' liability. These stockholders felt that if they provided additional money it would only be on condition that all question as to any further

stockholders' liability must be disposed of permanently. None of these stockholders would subscribe to that Class A stock unless they were released from any claim for stockholders' liability.

The following proceedings occurred before the Special Master on March 17, 1938:

Mr. Case: Now just bear with me. I have a right to comment on that (Section 5, Article 2, Page 29). He did not read it at all. Let us see just what they (Debtor and its subsidiary) did agree to do in order to induce the sale of these bonds. What did it say? (Reading Section 5, Article 2, Page 29 of the Trust Deed):

"That they will not apply for nor avail themselves of any injunctions or stay proceedings, or plead or in any way take advantage of any valuation law, apportionment law, appraisement law, stay law,"—they are trying to do that in this instance, "stay law or of any other law whether now in force or which may hereafter be enacted."—

Now, then, for what purpose?

"Which may in any way alter, impair or impede the rights or remedies of the holders of the bonds issued hereunder—and they hereby expressly waive all benefit and advantage of any and all such laws."

Are they trying to impede or impair or alter remedies which these bondholders have, especially the undeposited bondholders, by these objections? Are they trying to entirely emasculate their express tender to induce the sale of these bonds—that they are not going to impair or impede the rights or the remedies of the bondholders in any way or at any time.

On March 17, 1938, the motion of Mr. Case to strike out Debtor's Exhibits F, G, H & I was denied. On March 18, 1938, the hearing before the Special Master was as follows:

Mr. Case: At the adjournment of this proceeding yesterday afternoon, I understood your Honor to deny my motion to strike out those Exhibits. (Debtor's Exhibits F, G, H, & I.)

The Master: Yes.

Mr. Case: If it is necessary under the Federal practice I desire to note an exception to the ruling.

The Master: Very well.

Mr. Case: And then you asked me last night also, at the adjournment, to submit this matter of the amendment which was argued yesterday, and I will make that offer and suggest that it was introduced largely by way of estoppel.

The Master: Do you wish to make any motion predicated on this amendment to your answer, Mr. Case?

Mr. Case: So, based on this amendment to the answer of Case, secured creditor, we move that this proceeding be referred back to the District Court of the United States on the question that they are estopped by the provision of that Trust Deed recited in our Amended Answer or that your Honor make such other order as you deem fit in the premises.

The Master: The motion will be denied upon the ground that, in the opinion of the Special Master—what is the provision now so that I can read it?

Mr. Faries: Page 29.

The Master: Section 5 of Article 2 Page 29 Exhibit E being the original Trust Indenture, is void as contrary to sound public policy.

Mr. Case: Please note an exception to the ruling.

That provision of the Trust Deed as Debtor's Exhibit E is as follows:

Article II. The parties of the first part hereby severally covenant and agree:

Section 5. That they will not apply for nor avail themselves of any injunction or stay proceedings, or plead or in any way take advantage of any valuation law, apportionment law, appraisement law, stay law, or of any other law whether now in force or which may hereafter be enacted, which may in any way alter, impair or impede the rights or remedies of the holders of the bonds issued hereunder, or of the Trustee as herein provided, or which shall affect or change the time, place, means or mode of perfecting or enforcing such rights or remedies; and they hereby expressly waive all benefit and advantage of any and all such laws.

That they expressly waive the equity of redemption or right of repurchase, in case of any foreclosure sale hereunder, and agree that any and all such sales may be made free from any and all such rights.

On page 79 Section 11 of Article 9 of the Trust Deed, Debtor's Exhibit E, is as follows:

Section 11: Any of the provisions of this Indenture may be altered or abrogated, or additional terms and provisions of this Indenture adopted, by a Supplemental Indenture in writing, duly executed by the Lumber Company and the Drydock Company, and by the Trustee, and recorded in the same public offices in which this original Indenture is recorded, provided the execution of such Supplemental Indenture shall be consented to by the owners or holders of three fourths in principal amount of all bonds secured and then outstanding, hereunder, or

by the underwriters and owners or holders of a majority in principal amount of such bonds; and provided, further that no alteration shall be so made in this Indenture which shall create any discrimination or distinction whatever between any of the bonds secured and outstanding hereunder and any other of said bonds.

That on the 9th day of April 1938 the report of the Special Master was filed in this cause and on the 12th day of May, 1938 said Report was approved by the Court as set forth in its Interlocutory Order Confirming Plan of Reorganization, with the exception noted in said Order on pages 6 and 7 thereof;

That Exceptions and Objections to the Report of the Special Master were filed by Thomas K. Case and Adele B. Cowan as Dissenting, Secured Creditors, on the 15th day of April, 1938.

WHEREFORE, appellants prayed that the foregoing Amended Statement may be settled and allowed as correct as truly and properly setting forth a Statement of the evidence and proceedings had upon the hearing of the proposed plan of reorganization and matters to which the same pertained or related, and that the same presents a full true and correct statement of the evidence and proceedings herein had, and that upon a date to be set by the Court, the same be so settled and allowed and an order made that the said statement was filed pursuant to and in compliance with equity rules 75, 76 and 77.

Dated July 6th, 1938.

Thomas K. Case
Appellant in Propria Persona,
Clarke F. Bowker
by Robt. M. Clarke T.K.C.
Attorneys for Appellant Adele B. Cowan

The foregoing statement of the evidence and proceedings on the hearing of the proposed plan of reorganization, was prepared, served and lodged within the time allowed by law and thereafter and upon due notice thereof, duly and regularly given to Messrs. Faries & McDowell and Gibson, Dunn and Crutcher, attorneys for Debtor Corporation, the said statement of evidence and proceedings came on for hearing on the 6th day of July, 1938, debtor corporation, appellee herein, being then and there represented by Messrs. Faries & McDowell and Gibson, Dunn & Crutcher, its attorneys, and appellants herein then and there represented by Thomas K. Case and Robert M. Clarke,

It is hereby ordered that the foregoing statement of evidence and proceedings on the hearing of the proposed plan of reorganization, correctly sets forth proceedings had on the hearing of the proposed plan of reorganization and a portion of the evidence offered at such hearing and said statement is hereby settled and allowed as correct.

Done in open Court this 6th day of July, 1938.

Ralph E. Jenney
Judge of the United States District Court.

Approved July 6, 1938

Reuben G. Hunt
Special Master.

[Endorsed]: Filed R. S. Zimmerman Clerk at 7 min. past 2 o'clock Jul. 7, 1938 P. M. By Edmund L. Smith, Deputy Clerk.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

IN THE MATTER OF LOS ANGELES LUMBER PRODUCTS COMPANY, LTD. A CORPORATION, DEBTOR.	In Proceedings for Corporate Reorganization under 77 B. of the Bankruptcy Act. No. 31352 RJ.— In Bankrtupcy:
THOMAS K. CASE AND ADELE B. COWAN, Appellants, vs. LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., A Corporation, Appellee.	8841 PETITION FOR LEAVE TO APPEAL Under Section 24 B. of the Bankruptcy Act.

TO THE HONORABLE JUDGES OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT:

Your Petitioners, Thomas K. Case and Adele B. Cowan, secured creditors and dissenting bondholders of the above named Debtor and the holders of certain mortgage bonds of the par value of $18,500., issued by said corporation as "Los Angeles Lumber Products Company First Lien and Collateral Trust Twenty Year, Seven and one-half Per Cent Sinking Fund Gold Bonds", with interest

coupons attached, feeling themselves aggrieved by the order of the United States District Court for the Southern District of California, Central Division, entered on the 12th day of May, 1938, by the Honorable Ralph E. Jenney, one of the Judges of said court, confirming the Plan of Reorganization as amended, proposed for said Debtor under 77 B. of the Bankruptcy Act, file this their petition addressed to the discretion of this Honorable Court and pray for leave to appeal in matter of law from said Order of the District Court;

Petitioner Case has formally intervened in the Reorganization proceeding by way of Answer and Contravention and an Amendment to the Answer, permission to file which was granted;

Petitioners file herewith, attach hereto and make reference to their Assignment of Errors in which is set forth the errors alleged by your petitioners to have been made by the Court below, and setting forth the grounds for this appeal;

Petitioners set forth the following recital of facts:

1. that the petition of the Debtor and the report of the special master show that the primary purpose of the proceeding under 77 B. is to remove and cancel the first mortgage lien of bondholders which is secured by the Trust Deed herein known as Debtor's Exhibit E.;

2. that under the Order of the District Court the first mortgage liens have been discharged, cancelled and removed;

3. that the bondholders are thereby deprived of their substantive rights, among which are their right to foreclose the mortgage, to have a judicial sale of the pledged assets under the discretion of the Court, to bid at the

sale on the properties pledged in the Trust Deed, to have the rents and profits in the meantime and lose their right to realize on a deficiency claim against present very substantial stockholders;

4. that the bondholders, in addition to the loss of their first mortgage liens etc., would be deprived of all interest due and unpaid since February 1st, 1928, and also the premiums on the bonds all as promised in and made a part of the bonds;

5. that the Debtor corporation is insolvent "in the equity sense and in the bankruptcy sense";

6. that the present stockholders will receive under the reorganization, 23 per cent of the capital stock of the new corporation, as a gift and for which they pay nothing; that in addition to said 23 per cent, many of said present stockholders will receive a proportionate award to them of said new stock as owners of a large amount of said first mortgage bonds, and that present stockholders will completely control the new company;

7. that not only would present stockholders control and operate the new corporation but, in major part, they would acquire complete ownership of all assets pledged in the trust deed, freed from the first mortgage lien secured by said trust deed;

8. that all that the bondholders would receive for their bonds would be preferred stock, non-cumulative, in the new Company and nothing more, and that award to be on the basis of 250 shares of $1. par value new capital stock for each $1,000. bond "principal" and will lose all due and unpaid interest as provided in the bonds—which interest now approximately equals the principal amount of the bonds;

9. that the leasehold interest of the present Debtor in 66.54 acres of water frontage at Los Angeles Harbor, existing until the year 1952, and subject to renewal, for which Debor pays each year the sum of $21,500., is appraised at the sum of One Dollar;

10. that in order to improve its present unforunate condition, expand or enlarge its plant for new business, or engage in building large vessels at its shipbuilding plant, the corporation must secure money for necessary repairs and for new construction work "not exceeding $500,000.", but that present stockholders make no offer and no promise to financially aid the corporation when the new company is created;

11. that over 75 per cent of the bondholders deposited their bonds under agreement with a Bondholders Protective Committee and that they have received consideration therefor in the shape of present stock of the corporation and in lieu of some of the unpaid interest on their bonds;

12. that appellants are secured creditors and dissenting bondholders who have never deposited their bonds and have never consented to any proceedings since the time when said bonds were first issued in the year 1924, have never consented to the reorganization of Debtor corporation whereby the corporation became a limited company, have never consented to the reorganization proceedings in 1930, nor to any acts or proceedings since said date; that appellant Case's bonds representing a par value of $13,500. and appellant's bonds representing a par value of $5,000., were acquired by them prior to the year 1930, during which year and thereafter, the Supplements to the trust deed were created as Debtor's Exhibits F. G. H. & I.;

13. that petitioners herein claim by way of estoppel, that Debtor is estopped as against all dissenting bondholders, from indulging in this proceeding for reorganization and all proceedings which would "in any way, alter, impair or impede the rights of the holders of the bonds issued hereunder or in any way take advantage of any valuation law, stay law, or any other law, whether now in force or which may hereafter be enacted" etc. according to the provisions of section 5, Article 2, page 29 of the Trust Deed securing said bond issue and which has been specially pleaded by way of estoppel;

14. that as to all dissenting bondholders who have never deposited their bonds, never consented to any of the proceedings of the Debtor, have never joined in the release of the stockholders from their liability claim, who have never received any principal of their bonds and no interest since February 1st, 1929, have never received any shares of capital stock or anything of value, the Debtor claims that they are in the same legal position as that of the depositing bondholders whose consent to this plan is evidenced only by the vote of the Trustee under the terms of an agreement authorizing it to so proceed;

Points and authorities of petitioners are attached hereto as their EXHIBIT "A";

that attached hereto is a true and correct copy of the Order of Court Confirming the Plan, as petitioners EXHIBIT "B"; which is hereby made a part of this Petition for Leave to appeal;

that as part of this petition, also under separate cover, is a true and correct copy of the Report of the Special Master, as petitioners' EXHIBIT "C";

that as part of this petition, under separate cover, is a true and correct printed copy of the "Proposed Modification of Plan of Reorganization", as petitioners' EXHIBIT "D". This exhibit shows that the plan of Debtor, now confirmed by the District Court, is to issue preferred, non-cumulative, stock to the present Class A. stockholders who may own all of the voting stock of the present corporation, and to the bondholders of whom those Class A. stockholders are a major part. This new $1. par value stock furnishes the only consideration—if it would have any value at all, which the old and genuine bondholders would receive for the cancellation of their first mortgage bonds.

If permitted to appeal, the record on appeal will show that Debtor sold its bonds in the year 1929, at par or at 99½, and that it then bought the bonds back, years later, after continuing defaults in non-payment of the interest, at 6½ cents on the dollar, and that the Trustee now owns of these cheaply purchased bonds, $676,500. par value of those bonds and which it purchased through its wholly owned "affiliate the Security Company."

Still referring to our Exhibit D. (Debtor's Amended Plan) we attract this Court's attention to the fact that under that Plan the Debtor's estimate of 250 shares of $1. par value stock, for each $1,000. par value bond: "principal of the bonds" it calls it, looks as if Debtor was offering (dollar for dollar) one-fourth of the par value represented by these bonds.

THAT IS NOT EVEN HALF OF THE STORY. The due and unpaid interest now approximately equals the principal amount due on the bonds. Debtor refuses that interest and wants it forgotten. The legal claim for

principal and interest presents Debtor's offer as one-eighth only—par for par, not one-fourth.

It is our contention, and there is testimony to support it, that Debtor is a discredited corporation because published notices informed the public that debtor is under investigation by the Sabbath Congressional Investigating Committee and because for years, its bonds have been estimated in value at from 6½ cents on the dollar to eleven cents on the dollar, and its new $1. par value stock would have no market value and no honest sale value. It has so little faith in the future prospects that it refuses to make its proposed new "preferred Stock" cumulative.

To relegate first mortgage bondholders to the grossly inferior position of stockholders, at an estimate of one-eighth of the par value with interest, of these bonds, does make this "Plan" a little bit unfair.

In connection with Exhibit B, the Order of Court Confirming the Plan, designated "Interlocutory Order Confirming Plan of Reorganization", we have orally argued to the District Court that an order confirming the plan was required of it before Debtor would have any authority to proceed with its organization of the new Company; that the last act of Debtor designating this order an "interlocutory order" and that the sole purpose for the use by Debtor of the word "interlocutory", was in the hope of preventing our appeal at this time and from this particular order.

With the hope that this petition may be granted and an appeal be allowed, notwithstanding the use of the term "interlocutory order", we respectfully submit:

1. that without the word "interlocutory", this particular order confirming the plan, is the order required of the

District Court under paragraphs (g) and (h) of Section 77 B. of the Bankruptcy Act;

2. that without such an order confirming the plan, the Debtor has no authority to proceed with its amended plan of reorganization and which it is now doing;

3. that this order of the court materially and substantially affects the rights and the legal and equitable position of those dissenting bondholders who are asking permission to appeal;

4. that it is the only order confirming the plan;

5. that under this particular order of the Court which confirms the plan, these dissenting bondholders are deprived of their first mortgage lien, other substantive rights and remedies;

6. that this order is in reality the "final order" contemplated by section 77 B.;

7. that the only remaining order which the Court might be, later, disposed to make, would be several months hence, and perhaps never, approving only the subsequent acts of Debtor after it had effected its reorganization under the plan;

8. that in that last possible order, dissenting bondholders would have no concern—if the plan should be sustained on appeal;

9. that merely calling this order an "interlocutory order" should not be permitted to defeat this petition for leave to appeal;

10. that under Section 77 B. no interlocutory order is mentioned or contemplated by that statute;

11. that to delay our petition for leave to appeal until some possible order might be made approving of the subsequent acts of debtor when the new company was finished and our bonds cancelled, would mean that our right to petition for leave to appeal would have been lost forever, by lapse of time;

12. that soon after this particular order was made, as stated in open court by counsel for debtor, on May 5th, 1938, the bonds will be "cremated".

WHEREFORE, your petitioners pray that they may be granted leave to appeal in matter of law herein and that a Citation be issued, directed to Los Angeles Lumber Products Company, Ltd., a corporation, commanding it to appear before the United States Circuit Court of Appeals for the Ninth Circuit, to do and receive what may appertain to Justice to be done in the premises and that a transcript of the record and proceedings, duly authenticated, may be transmitted to the Circuit Court of Appeals for the Ninth Circuit.

Dated this 13th day of May, 1938.

Thomas K. Case
Appellant in Propria Persona.

Adele B. Cowan
Appellant,

by Clarke & Bowker
Her Attorneys.

By Robt. M. Clarke

United States Circuit Court of Appeals,)
Ninth Circuit,)
State of California,) ss:
County of Los Angeles.)

I, Thomas K. Case, secured creditor and a petitioner named in the foregoing petition for Leave to Appeal, being duly sworn, depose and say that I have read said Petition for Leave to Appeal under section 24 b. of the Bankruptcy Act, to the United States Circuit Court of Appeals for the Ninth Circuit, and know the contents thereof; that the same is true of my own knowledge except as to matters therein stated on information or belief and that as to such matters and all other statements of facts therein contained, I believe them to be true.

Thomas K. Case

Subscribed and sworn to before me this 13th day of May, 1938.

[Seal] Joseph P. Johnston
Notary Public in and for the County of Los Angeles, State of California.

(Endorsed) Petition for Appeal. Filed May 16, 1938. Paul P. O'Brien, Clerk.

No. 8841.

[TITLE OF CIRCUIT COURT OF APPEALS AND CAUSE.]

ASSIGNMENT OF ERRORS

Now come Thomas K. Case and Adele B. Cowan, Petitioners for Leave to Appeal under Section 24 b. of the Bankruptcy Act and file this their Brief and Assignment of Errors herein, asserting that the Honorable District Court of the United States, for the Southern District of California, Central Division, in its order confirming the plan of reorganization of the above named corporation and Approving the Report of the Special Master, erred as follows, to-wit:

—I—

By depriving petitioners, as dissenting bondholders, of their first mortgage lien, of the right to foreclose and other substantive rights:

Horn vs. Ross Island Sand & Gravel Co., 88 Fed. (2d) 64;

Sec.-First Nat'l. Bank vs. Rindge L. Co., 85 Fed. (2) 557;

Louisville Joint Stock L. Co. vs. Radford, 295 U. S. 555;

In re Day & Meyer, 98 Fed. (2) 657, decided Jan. 3rd, 1938;

Francisco Corpn. vs. Battson, 83 Fed. (2) 23;

Tenn. Pub. Co. vs. Am. Nat'l Bank, 81 Fed. (2) 463; Affirmed by Supreme Court in 299 U. S. 18;

Reading Hot. Corpn. vs. Prot. Com., 89 Fed. (2) 53.

—II—

By allowing to present stockholders of an insolvent corporation, in which they have no equity, 23 per cent of the capital stock of the new corporation to be organized under the Plan.

In the latest case on that subject, In re Day & Meyer, 93 Fed. (2) 657, (2nd Circuit), that court held:

"The Bankruptcy Court must scrutinize reorganization plans for insolvent companies, to make certain that assets belonging to creditors, are not by indirection, diverted to stockholders. Bankr. Act 77 B.

Also

Reading Hotel Corpn. vs. Prot. Com., 89 Fed. (2) 53, where "Stockholders had no equity";

" Wayne Un. Glass vs. Owens, Ills. Glass Co., 91 Fed. (2) 827,

" Horn vs. Ross Island, 88 Fed. (2) 64;

" Gerdes on Corporate Reorganization, page 1740.

" In re Day & Meyer, 93 Fed. (2) 657, where the plan "reduced to one-half of principal amount of the bonds" to "create an equity" was "unfair and should not have been confirmed."

—III—

Because the Plan is not "Fair", gives no compensation to dissenting bondholders for the loss of their lien and does not afford them the "adequate protection" provided in 77 B. subd. (b) (5) of the Bankruptcy Act.

Sec.-First Nat'l. Bank vs. Rindge Land Co., 85 Fed. (2) 557,

Horn vs. Ross Island S. & G. Co., 88 Fed. (2) 64,

In Re Day & Meyer, 93 Fed. (2d) 657,

Preble Corporation vs. Wentworth, 84 Fed. (2) 73

In Re Merrell Holding Corpn., 29 Am. Bank. Rep. NS, 290,

Texas Hotel Sec. Corpn. vs. Waco Develpt. Co., 87 Fed. (2) where on page 400 et seq., that Court at considerable length analyzed the "adequate protection" clause of the Bankruptcy Act.

—IV—

Dissenting bondholders, as a minority, are not bound by any majority of consenting bondholders, however large, and cannot be deprived of their rights "as non-assenting creditors" by any kind of a contract to which they are not actually a party.

Possibly the parent case on this subject is that of Gilfillan vs. Union Canal Co., 109 U. S. 401, where that Court held:

"No majority, however large, can compel a minority, small though it be, to enter into such an agreement against their will, and, under the Constitution of the United States, it is probable that no statute of a state, passed after the bonds were issued, subjecting the minority to the provisions of the agreement, without their consent, would be valid."

In Northern Pacific Railway Co. vs. Boyd, 228 U. S. 482, a Railroad case with public interest involved, the Supreme Court said:

"Contracts for reorganization made between bondholders and stockholders of corporations, insolvent or financially embarrassed, involving the transfer of corporate property to a new corporation, while proper and binding between the parties, cannot, even when made in good faith, defeat

the claims of non-assenting creditors; nor is there any difference whether the reorganization be made by contract or at a private sale, or consummated by a Master's Deed under a consent decree.

Even in the absence of fraud, any device whether by private contract or under judicial sale whereby stockholders are preferred to creditors, is invalid."

In First National Bank vs. Flershem, 290 U. S. 504, the Court held that "95 per cent of all outstanding debentures were deposited under the plan" but could not dominate a small minority or deprive it of its lien, "substantive right" and that the minority (petitioners) were entitled to payment in full. (Ppps 519-521)

To same effect:

Horn v. Ross Island, 88 Fed. (2) 64 (only 1 dissenting bondholder and 75½ majority.) And several other cases.

—V—

Because the interest promised in and an integral part of the bonds cannot be taken from dissenting bondholders:

American Iron & S. Co. vs Seaboard Airline, 233 U. S. on p. 266

In re Seman, 11 Fed. Suppl. 18,

In re Day & Meyer, 93 Fed. (2) 657,

77 B. of the Bankruptcy Act (b) (10) contains the following:

"In case of secured claims entitled to the provisions of clause (5) of this subdivision (b) the value of the security shall be determined in the manner provided in section 57, clause (h) of this Act."

Section 57, clause (h) is as follows:

"The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors."

In Johnson vs. Norris, 190 Fed. 459, 460, where the Court held: Creditors in bankruptcy were entitled to interest "accruing after adjudication". (page 267 of 233 U. S. Reports.

Very much more unfair is Debtor's plan in this case (offering nothing but shares of stock) than was the plan involved in the late case of Day & Meyer, 93 Fed. (2) 657. In that case the Debtor only sought to "reduce to one-half" the principal amount of the bonds, thus eliminating (as here) the interest on those bonds. These were the only two points involved. Yet that Court, in the 2nd Circuit, held:

"A reorganization plan providing that first mortgage bonds be reduced to one-half of their principal amount and the equity thereby created be represented by the issuance of new preferred and common stock "* * * and eliminating the total amount of interest past due on the bonds, was unfair and should not have been confirmed * * * since the plan did not preserve priorities and deprived bondholders of their lien."

—VI—

Debtor's Plan is not "fair"; it is not "equitable", it is not "feasible", in the sense that it will give in the new company, control to the old—present—stockholders, as indicated in this Brief and will be shown on appeal—if appeal is permitted.

We are enclosing and including as parts of the record to enable this Court to exercise its discretion, in addition to Exhibit A, the Assignment of Errors and Brief, the following:

As Petitioners' Exhibit B., the order of the District Court confirming the Plan;

As petitioners' Exhibit C., a copy of the Report of the Special Master; and

As petitioners' Exhibit D., a printed copy of the Amended Plan which has been confirmed by the District Court.

RESPECTFULLY SUBMITTED:

Thomas K. Case
In propria persona.

Adele B. Cowan
Dissenting creditor,
by Clarke & Bowker
Her attorneys.

(Endorsed) Assignment of Errors. Filed May 16, 1938. Paul P. O'Brien, Clerk.

Clerk's Note: Exhibits B, C and D above referred to are not printed here for they are already set forth in the transcript, in their proper places.

At a Stated Term, to-wit: The October Term A. D. 1937, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City and County of San Francisco, in the State of California, on Wednesday the eighteenth day of May in the year of our Lord one thousand nine hundred and thirty-eight.

PRESENT:

Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding,

Honorable CLIFTON MATHEWS, Circuit Judge,

Honorable WILLIAM HEALY, Circuit Judge.

THOMAS K. CASE and ADELE B. COWAN, Appellants, vs. LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a Corporation, Appellee.	)	ORDER ALLOWING APPEAL No. 8841

Upon consideration of the petition of Thomas K. Case and Adele B. Cowan, filed May 16, 1938, for allowance of appeal herein under section 24(b) of the Bankruptcy Act, and of the assignment of errors thereon, filed therewith, and by direction of the court.

IT IS ORDERED that an appeal to the United States Circuit Court of Appeals for the Ninth Circuit from the order of the District Court of the United States for the Southern District of California, Central Division, made and entered on the 12th day of May, 1938, be, and the same hereby is allowed, conditioned upon the giving of a cost bond in the sum of Two Hundred and Fifty Dollars ($250.00) with good and sufficient security, within ten days from date.

IT IS FURTHER ORDERED that if an appeal has been heretofore allowed in this cause by said District Court, and a cost bond given on such appeal, then no additional cost bond need be given on this appeal.

[Endorsed]: Receipt of copy of order allowing appeal in 8841, U. S. Circuit Court of Appeals, Ninth Circuit, is hereby admitted this 20th day of May, 1938. Faries & McDowell Attorneys for Debtor & Appellee By W. R. Hachest.

[TITLE OF CIRCUIT COURT OF APPEALS AND CAUSE.]

COST BOND *OF* APPEAL.

WHEREAS, Thomas K. Case and Adele B. Cowan, dissenting bondholders and non-assenting secured creditors of the above named Debtor Corporation, are about to appeal to the United States Circuit Court of Appeals for the Ninth Circuit, from an order of the District Court of the United States, Southern District of California, Central Division, confirming the plan of reorganization of the above named Debtor, entered on the 12th day of May, 1938:

NOW, THEREFORE, in consideration of the premises and of such appeal, we, the undersigned, as principals, and Hartford Accident and Indemnity Company, a Corporation organized and existing under the laws of the State of Connecticut and authorized to transact surety business in the State of California, as Surety, do hereby jointly and severally undertake and promise on the part of the above named appellants, that said appellants will pay all damages and costs which may be awarded against *the*, or either of them, on said appeal or on dismissal thereof, not exceeding Two Hundred and Fifty ($250.00) Dollars, to which amount we acknowledge ourselves jointly and severally bond.

DATED: May 19th, 1938.

THOMAS K. CASE

Principal

ADELE B. COWAN

Principal

HARTFORD ACCIDENT & INDEMNITY COMPANY

BY H. B. PARKHURST [Seal]
H. B. PARKHURST,
Attorney-in-fact

This bond is approved:

Geo. Cosgrave
U. S. District Judge

May 19th—1938

STATE OF CALIFORNIA, }
County of Los Angeles } ss.

On This 19th day of May, A. D., 1938, before me, H. B. Parkhurst a Notary Public in and for said County and State, personally appeared THOMAS K. CASE, known to me, (or proved to me on the oath of .....), to be the person whose name is subscribed to the within Instrument, and acknowledged to me that he executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] (Signed) H. B. Parkhurst
Notary Public in and for said County and State.

STATE OF CALIFORNIA, }
County of Los Angeles } ss.

On This 19th day of May, A. D., 1938, before me, H. B. Parkhurst a Notary Public in and for said County and State, personally appeared Adele B. Cowan, known to me,

(or proved to me on the oath of.....), to be the person whose name is subscribed to the within Instrument, and acknowledged to me that she executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] (Signed) H. B. Parkhurst
Notary Public in and for said County and State.

STATE OF CALIFORNIA, }
County of Los Angeles, } ss.

On this 19th day of May, 1938, before me, OPAL GRAVES, a Notary Public in and for the said County of Los Angeles, State of California, residing therein, duly commissioned and sworn, personally appeared H. B. Parkhurst, known to me to be the Attorney-in-Fact, of the HARTFORD ACCIDENT AND INDEMNITY COMPANY, the Corporation that executed the within instrument, and acknowledged to me that he subscribed the name of the HARTFORD ACCIDENT AND INDEMNITY COMPANY thereto and his own name as Attorney-in-Fact.

[Seal] Opal Graves
Notary Public, in and for the County of Los Angeles, State of California.

My Commission Expires 6/18/38

[Endorsed]: Filed R. S. Zimmerman Clerk at 45 min. past 1 o'clock May 20, 1938 P. M. By M. J. Sommer, Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

No. 31,352 R. J.
IN BANKRUPTCY.
ON APPEAL No. 8841

STIPULATION CONCERNING RECORD

IT IS HEREBY STIPULATED AND AGREED, by and between Appellants Thomas K. Case and Adele B. Cowan, and Appellee Los Angeles Lumber Products Company, Ltd., through their undersigned counsel of record in the above mentioned matter, subject to the approval of Judge R. E. Jenney, Judge of the above entitled Court, that the Record on Appeal in said action shall consist of the items listed in Appellants' Amended Praecipe, together with the Statement of Evidence prepared by Appellants. This stipulation is made and a complete record is not required by the Debtor with the understanding and agreement that on this Appeal Appellants will not rely on the Statement of Facts as contained in their Petition for Leave to Appeal, but will restate the same based solely on the Record on Appeal, and that on this Appeal they intend to raise questions of substantive law only; that they will not question the regularity of any proceedings had, and will not attack the findings of the trial court on the ground that they are unsupported by evidence, and that the Statement of Evidence prepared by Appellants will be used to support the arguments of Appellants on questions of substantive law as hereinafter set forth,

and that on this Appeal, in lieu of the points set forth in their assignment of errors, they will raise the following points only:

1. The trial court erred in depriving Appellants as dissenting bondholders, of their first mortgage lien, of the right to foreclose, and other substantive rights;

2. The trial court erred in allowing the present stockholders of Los Angeles Lumber Products Company, Ltd., an insolvent corporation, to participate in the Plan of Reorganization, in which Appellants contend they have no equity, either to the extent of 22½ per cent or other percentage;

3. The Appellants contend that the Plan is not fair because no compensation is provided for dissenting bondholders for the loss of their lien and does not afford them the "adequate protection" provided in 77B, subdivision b. (5) of the Bankruptcy Act;

4. That dissenting bondholders, as a minority, are not bound by any majority of consenting bondholders, however large, and cannot be deprived of their rights as "non-assenting creditors" by any kind of a contract to which they are not actually a party even though more than 75% have consented to the proposed Plan;

5. That Appellants contend that the interest promised in the bonds, and an integral part of the bonds, cannot be taken from the dissenting bondholders under authority of law;

6. Appellants contend that as to them said Plan is neither fair, equitable nor feasible and is discriminatory.

DATED: June 30th, 1938.

Thomas K. Case
Thomas K. Case, in propria persona
CLARKE & BOWKER,
By Robt M. Clarke
Attorneys for Appellant Adele B. Cowan

FARIES & McDOWELL,
By J. Clifford Argue and
GIBSON, DUNN & CRUTCHER,
By Stuart L. Lapp
Attorneys for Appellee

Approved July 6—1938

Reuben G. Hunt
Special Master

[Endorsed]: Filed R. S. Zimmerman, Clerk at 7 min. past 2 o'clock Jul. 7, 1938 P. M. By Edmund L. Smith Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

ON APPEAL: No. 8841.

APPELLANT'S AMENDED PRAECIPE

TO THE CLERK OF THE DISTRICT COURT OF THE UNITED STATES, SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION:

SIR:

Please issue, at Appellants' expense certified printed transcript of Record on Appeal in the above mentioned case, consisting of the following documents:

1. Petition for Reorganization under the provisions of 77B of the Bankruptcy Act, comprehending pages 1 and to and including page 14 thereof, filed January 28th, 1938;

2. The Plan of Reorganization, as Debtor's Exhibit "F", attached to said Petition for Reorganization, comprehending pages 1 to 12 inclusive, filed herein on January 28th, 1938;

3. The Proposed Modification of Plan of Reorganization, filed April 8, 1938;

4. The Report of the Special Master, filed April 8th, 1938;

5. The Exceptions and Objections to Report of Special Master by Thomas K. Case and Adele B. Cowan, filed April 15th, 1938;

6. The Oral Opinion of the Court on April 22nd, 1938, thereafter transcribed;

7. The Interlocutory Order confirming Plan of Reorganization, filed and entered on May 12th, 1938;

8. The statement of the evidence when settled by the District Court of the United States;

9. The Answer to Petition and Contravention by Thomas K. Case, filed March 7th, 1938;

10. The Addition and Amendment to Answer of Thomas K. Case, filed March 16th, 1938;

11. Petition to Circuit Court of Appeals for Leave to Appeal under Section 24 of the Bankruptcy Act, with Assignment of Errors therein, filed May 16th, 1938, in United States Circuit Court of Appeals;

12. The Order of the United States Circuit Court of Appeals Allowing the Appeal, issued May 18th, 1938;

13. The Citation on Appeal issued by the United States Circuit Court of Appeals, directed to Debtor, dated May 18th, 1938;

14. The Bond on Appeal for Costs, filed and approved on May 21st, 1938, by Circuit Judge Wilbur.

15. Stipulation Concerning Record dated June 30th, 1938.

DATED: July 5th, 1938.

Please print 40 copies.

Thomas K. Case
Thomas K. Case in propria persona
CLARKE & BOWKER,
Robert M. Clarke
Attorneys for Appellant Adele B. Cowan.

[Endorsed]: Filed R. S. Zimmerman Clerk at 7 min. past 2 o'clock July 7, 1938 P. M. By Edmund L. Smith Deputy Clerk.

[TITLE OF DISTRICT COURT AND CAUSE.]

CLERK'S CERTIFICATE.

I, R. S. Zimmerman, clerk of the United States District Court for the Southern District of California, do hereby certify the foregoing volume containing 289 pages, numbered from 1 to 289 inclusive, to be the Transcript of Record on Appeal in the above entitled cause, as printed by the appellant, and presented to me for comparison and certification, and that the same has been compared and corrected by me and contains a full, true and correct copy of the citation; original petition of debtor with Exhibits C, D, E and G omitted therefrom but with Exhibit F included; answer to petition and contravention by Thomas K. Case, a secured creditor; addition and amendment to answer; proposed modification of plan of reorganization; report of Special Master; exceptions and objections to report of Special Master; interlocutory order confirming plan of reorganization; reporter's transcript of opinion of the court; opinion of the court; statement of evidence; petition for leave to appeal; assignment of errors with Exhibits B, C and D omitted therefrom; order allowing appeal; cost bond on appeal; stipulation concerning record, and amended praecipe.

I DO FURTHER CERTIFY that the amount paid for printing the foregoing record on appeal is $307.80 and that the amount of $47.80 has been paid by the appellee and $260.00 has been paid by the appellant herein and a receipted bill is herewith enclosed, also that the fees of the Clerk for comparing, correcting and certifying the fore-

going Record on Appeal amount to $36.90 and that said amount has been paid me by the appellant herein and $6.60 paid by appellee.

In Testimony Whereof, I have hereunto set my hand and affixed the Seal of the District Court of the United States of America, in and for the Southern District of California, Central Division, this 11th day of August, in the year of Our Lord One Thousand Nine Hundred and Thirty-eight and of our Independence the One Hundred and Sixty-third.

[Seal] R. S. ZIMMERMAN,
Clerk of the District Court of the United States of America, in and for the Southern District of California.

By R. S. ZIMMERMAN.

[Endorsed]: Printed Transcript of Record. Filed August 12, 1938. Paul P. O'Brien, Clerk.

No. 8951

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

THOMAS K. CASE and
ADELE B. COWAN,

Appellants,

vs.

LOS ANGELES LUMBER PRODUCTS
COMPANY, LTD., a corporation,

Appellee.

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

Parker Printing Company, 545 Sansome Street, San Francisco

In the United States Circuit Court of Appeals
for the Ninth Circuit

In Proceedings for Corporate Reorganization Under
77B of the Bankruptcy Act
No. 31352 RJ.—In Bankruptcy

No. 8951

In the Matter of

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a Corporation,

Debtor,

THOMAS K. CASE and
ADELE B. COWAN,

Appellants,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a Corporation,

Appellee.

PETITION FOR LEAVE TO APPEAL UNDER SECTION 24 b. OF THE BANKRUPTCY ACT, FROM THE FINAL ORDER CONFIRMING PLAN OF REORGANIZATION.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Your petitioners, Thomas K. Case and Adele B. Cowan, secured creditors and dissenting bondholders of the above named Debtor and the holders of certain mortgage bonds of the par value of $18,500, issued by said Corporation as "Los Angeles Lumber Prod-

ucts Company First Lien and Collateral Trust Twenty Year, Seven and one-half per cent Sinking Fund Gold Bonds," with interest coupons attached, feeling themselves aggrieved by the Final Order of the District Court of the United States for the Southern District of California, Central Division, made and entered on the 19th day of July, 1938, by the Honorable Ralph E. Jenney, one of the Judges of said Court, Confirming the Plan of Reorganization proposed for said debtor under 77B of the Bankruptcy Act, file this their petition addressed to the discretion of this Honorable Court and pray for leave to appeal in matter of law from said Final Order of the District Court;

Petitioner Case formally intervened in the reorganization proceeding, by way of Answer and Contravention and Amendment to said Answer, permission to file which was granted;

Petitioners file herewith, attach hereto and make reference to, their Assignment of Errors in which is set forth the errors alleged by your petitioners to have been made by the District Court, and setting forth the grounds for this appeal;

Petitioners allege that there is now pending an appeal to this Honorable Court, known as No. 8841, and which is between the same parties as those specified herein; that said appeal No. 8841, was taken from the "Interlocutory" Order Confirming the same plan of reorganization, that the Transcript has been filed therein and that said cause presents and will present, all of the record and the only briefs which will be filed and used on this new appeal, if

granted, from the Final Order of the same District Judge;

That said Final Order is in most respects the same as the Interlocutory Order involved in cause No. 8841, but contains in addition, the findings of the District Court approving of the subsequent acts of the debtor corporation which proceeded with the reorganization authorized in said Interlocutory Order, after the appeal therefrom was allowed by this Honorable Court;

That the same Plan is involved in both appeals;

That it is the desire of all counsel for all parties represented in both appeals, to use is this new appeal (if it is allowed) the one transcript and the one record to be presented in the appeal now pending in cause No. 8841, and that counsel hope that this Honorable Court will consolidate the two appeals;

That this application for permission to appeal from the final order of the District Court, is filed because it may be proper or necessary to have before the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit, the final order of the District Court made since the appeal was taken and allowed from the Interlocutory order Confirming Plan of Reorganization;

That in this appeal, if granted, no new or additional transcript or record is desired by any of the parties hereto and that all of said parties and their counsel, desire to rely upon the transcript on file,

the record and the briefs to be filed and used by appellants and appellee in Cause No. 8841;

Petitioners set forth the following recital of facts:

1. That the petitioner of debtor and the orders of the Court show that the primary purpose of the proceeding under 77B is to remove and cancel the first mortgage lien of bondholders, which is secured by the Trust Indenture herein known as Debtor's Exhibit E;

2. That under the Orders of the District Court, the first mortgage liens have been discharged, cancelled and removed and that Debtor is authorized to retain the assets pledged in said Trust Indenture;

3. That the bondholders are thereby deprived of their substantive rights, the first mortgage lien, the right to foreclose, etc.;

4. That the bondholders, in addition to the loss of their first mortgage liens, have been deprived of all interest due and unpaid since February 1st, 1929;

5. That the debtor corporation is insolvent "in the equity sense and in the bankruptcy sense";

6. That the present stockholders will receive under the reorganization 22½ per cent. of the capital stock of the new corporation;

7. That in addition to said 22½ per cent., present stockholders will receive a proportionate award to them of said new stock, as owners of a large amount of said first mortgage bonds and will control the new company;

8. That all that the bondholders would receive for their bonds would be preferred stock, non-

cumulative, in the new company and that the award would be on the basis of 250 shares of $1 par value new stock for each $1,000 bond, principal only;

9. That the leasehold interest of debtor in 68.54 acres of water frontage at Los Angeles Harbor, existing until the year 1952 and subject to renewal thereafter, for which debtor pays each year, the sum of $21,500, is not appraised herein but is valued by debtor at the sum of One Dollar;

10. That appellants are secured creditors and dissenting bondholders who have never deposited their bonds and have never consented to this proceeding for reorganization or to any other proceedings and that appellants' bonds were acquired prior to 1930;

11. That petitioners herein claim by way of estoppel, that debtor is estopped as against appellants, from indulging in this proceeding for reorganization, under the provisions of section 5, Article 2, page 29 of the trust indenture securing said bond issue and which has been specifically pleaded by way of estoppel.

Points and Authorities of petitioners are attached to this petition as their Exhibit A:

That attached hereto is a true and correct copy of the Final Order of the District Court Confirming the plan of reorganization as petitioners' Exhibit B as part of this petition;

That attached hereto is a copy of the Stipulation entered into between all counsel for the parties represented herein, requesting consolidation of this appeal with the appeal proceedings pending before

this Honorable Court in Cause No. 8841, as petitioners' Exhibit C;

That for the purpose of the record for this new appeal, petitioners rely on the transcript, the record and the briefs to be filed, constituting the record in cause No. 8841, and upon said stipulation to consolidate these appeals;

That included herewith, under separate cover, is the original Stipulation which all counsel have signed and in which they request the consolidation of these appeals—if the Honorable Judges of the United States Circuit Court of Appeals will permit that to be done.

Wherefore, petitioners pray that they may be granted leave to appeal in matter of law herein, that a Citation be issued, directed to Los Angeles Lumber Products Company, Ltd., a corporation, commanding such action by it as may seem proper, that this appeal proceeding be consolidated with cause No. 8841 and that the record and transcript therein, and the briefs to be filed therein, all constitute and be the record on appeal in this appeal from the Final Order of the District Court.

Dated August 11th, 1938.

THOMAS K. CASE,
Appellant in propria persona.
ADELE B. COWAN,
Appellant, by
CLARKE AND BOWKER,
By ROBERT M. CLARKE,
Her Attorneys.

United States Circuit Court
of Appeals, Ninth Circuit,
State of California, County of Los Angeles—ss.

I, Thomas K. Case, secured creditor and a petitioner named in the foregoing petition for Leave to Appeal, being duly sworn, depose and say that I have read said petition for leave to appeal under section 24b of the Bankruptcy Act to the United States Circuit Court of Appeals for the Ninth Circuit, and know the contents thereof; that the same is true of my own knowledge except as to matters therein stated on information or belief and that as to such matters and all other statements of facts therein contained, I believe them to be true.

THOMAS K. CASE.

Subscribed and sworn to before me this 11th day of August, 1938.

[Seal] DeWITT E. STRODE,
Notary Public in and for the County of Los Angeles,
State of California.

My commission expires Aug. 17, 1940.

EXHIBIT A

[Title of Circuit Court of Appeals and Cause.]

ASSIGNMENT OF ERRORS

Now come Thomas K. Case and Adele B. Cowan, Petitioners for Leave to Appeal under section 24b of the Bankruptcy Act and file this their brief and Assignment of Errors herein, asserting that the Honorable District Court of the United States, for the Southern District of California, Central Division, in its Final Order Confirming the Plan of Reorganization of the above named corporation and Approving the Report of the Special Master, erred as follows, to-wit:

I.

By depriving petitioners, as dissenting bondholders, of their first mortgage lien, of the right to foreclose and other substantive rights:

Horn v. Ross Island Sand & Gravel Co., 88 Fed. (2) 64,

Sec.-First Nat'l Bank v. Rindge L. Co., 85 Fed. (2) 557,

Louisville Joint Stock L. Co. v. Radford, 295 U. S. 555,

In re Day & Meyer, 93 Fed. (2) 657, decided Jan. 3rd, 1938,

Francisco Corpn v. Battson, 83 Fed. (2) 93,

Tenn. Pub. Co. v. Am. Nat'l Bank, 81 Fed. (2) 463,

Reading Hotel Corpn. v. Prot. Com., 89 Fed. (2) 53.

II.

By allowing present stockholders of an insolvent corporation, in which they have no equity, 22½ per cent of the capital stock of the new corporation to be organized under the Plan:

In re Day & Meyer, 93 Fed. (2) 657,
Reading Hotel Corpn. v. Prot. Com., 89 Fed. (2) 53,
Wayne Un. Glass v. Owens Ills. Glass, 91 Fed. (2) 827,
Horn v. Ross Island, 88 Fed. (2) 64,
Gerdes on Corp. Reorganization, page 1740.

III.

Because the Plan is not "Fair," gives no compensation to dissenting bondholders for the loss of their first mortgage lien and does not afford them the "adequate protection" provided in Section 77B of the Bankruptcy Act, subd. (b), (5):

Sec.-First Nat'l Bank v. Rindge Land Co., 85 Fed. (2) 557,
Horn v. Ross Island S. & G. Co., 88 Fed. (2) 64,
In re Day & Meyer, 93 Fed. (2) 657,
Preble Corpn. v. Wentworth, 84 Fed. (2) 173,
In re Murrell Holding Corpn., 29 Am. Bankr. Repts. (NS.) 290,
Texas Hotel Sec. Corpn. v. Waco Devt. Co., 87 Fed. (2) on page 400.

IV.

Because dissenting bondholders, as a minority, or not bound by any majority of consenting bond-

holders, however large, and cannot be deprived of their rights as "non-assenting creditors" by any kind of a contract to which they are not actually a party:

Gilfillan v. Union Canal Co., 109 U. S. on p. 401,

Northern Pacific Ry. Co. v. Boyd, 229 U. S. 432,

First National Bank v. Florshem, 290 U. S. 504,

Horn v. Ross Island, 88 Fed. (2) 64 and other cases.

V.

Because the interest promised in and an integral part of the bonds cannot be taken from the dissenting bondholders:

American Iron & S. Co. v. Seaboard Airline, 233 U. S., p. 266,

In re Seman, II Fed. Suppl. 18,

In re Day & Meyer, 93 Fed. (2) 657,

Johnson v. Morris, 190 Fed. 459-460.

VI.

Because Debtor's Plan is not "fair," it is not "equitable," it is not "feasible" in the sense that it contemplates the possibility of future profits for the new company and which may or may not occur and concerning which dissenting bondholders cannot be compelled to await and that the plan would give control to present stockholders of the old company provided necessary repairs are made to the shipbuilding plant.

Petitioners are enclosing and including as parts of this record to enable this Court to exercise its discretion, in addition to Exhibit A the Assignment of Errors, the following:

As petitioners' Exhibit B, the Final Order Confirming the Plan,

As petitioners' Exhibit C, the Stipulation between Counsel requesting this Court to consolidate this appeal, if allowed, with the appeal in Cause No. 8841, thus using the transcript and briefs therein, in connection with this appeal.

Respectfully submitted,

THOMAS K. CASE,
In propria persona,
ADELE B. COWAN,
Dissenting Creditor,
By CLARKE & BOWKER,
By ROBERT M. CLARKE,
Her Attorneys.

[Endorsed]: Filed Aug. 12, 1938. Paul P. O'Brien, Clerk.

EXHIBIT B

In the District Court of the United States for the Southern District of California, Central Division.

No. 31,352 R. J.

In the Matter of

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,

Debtor.

FINAL ORDER CONFIRMING PLAN OF REORGANIZATION

This cause came on regularly to be heard on March 21st, 1938, before the Honorable Ralph E. Jenney, Judge of the above court, on the proposal, consideration and confirmation of the Plan of Reorganization filed herein by Debtor, pursuant to the order of this court entered on January 28, 1938, said hearing having been continued to April 11, 1938, and prior thereto, and on or about March 18, 1938, a modification of said Plan of Reorganization had been proposed and filed herein by Debtor and set for hearing by order of court on April 11, 1938 (said plan of reorganization and modifications thereto being hereinafter referred to as "the Plan"), and said matters having come on regularly for hearing on said date and having been continued from time to time pursuant to order of this court, were concluded on April 22, 1938, and an interlocutory order confirming the Plan was entered on May 12, 1938. At said hearings the following appeared:

Faries & McDowell by J. Clifford Argue and David R. Faries and Gibson, Dunn & Crutcher by J. C. Macfarland, as counsel for Debtor.

Thomas K. Case, bondholder, in propria persona, holding Thirteen Thousand Five Hundred ($13,500.00) Dollars principal amount of bonds.

George R. Larwill and Frank S. Balthis, Jr., on behalf of Thomas A. Ogden, May Justice Johnson, Mary O. Rivers, Edwin M. Rankin and Maude M. Rankin, C. W. Olsen, Helen Avery Cameron, Emma L. Rooks, Merrit W. Linscott and Anna Edge Linscott and William Wildburger, bondholders holding Thirty-three Thousand ($33,000.00) Dollars principal amount of bonds.

William Schoenau, Jr., bondholder, in propria persona, holding Twelve Thousand Five Hundred ($12,500.00) Dollars principal amount of bonds.

Clarke & Bowker and Earle E. Moss on behalf of Adele M. Cowan, bondholder, holding Five Thousand ($5,000.00) Dollars principal amount of bonds.

Overton, Lyman & Plumb by C. L. McGaughey on behalf of Charlene Coulter and Mary E. Priest, bondholders, holding Fourteen Thousand Five Hundred ($14,500.00) Dollars principal amount of bonds.

It appearing to the Court that the Debtor was directed in the Interlocutory Order of May 12, 1938, to report in writing on May 31, 1938, at the hour of 2 o'clock P. M. of said day concerning its compliance with said order and particularly concerning the organization of the new company and whether

the new company is authorized by its Charter or applicable State or Federal laws, upon confirmation of the Plan, to take all action necessary to carry out the Plan. It further appearing that said hearing was duly continued by announcement in open court on May 31, 1938, to June 13, 1938, and that said matter came on for hearing on June 13, 1938, at which time Debtor filed its report, and the matter having been continued by announcement in open court to June 20, 1938, the Court, upon consideration of the evidence and testimony presented before the Special Master and the report and recommendation of the Special Master, the report filed by Debtor and all exhibits and proof introduced into this cause, and all proceedings herein, and the Court having heard the arguments of counsel, and the matter having been submitted to the Court for decision;

The Court Finds:

(1) That Los Angeles Lumber Products Company, Ltd., herein called the Debtor, is a corporation organized and existing under the laws of the State of California, and that its principal place of business is and has been during the six months preceding January 28, 1938, in the City of Los Angeles, County of Los Angeles, State of California, which is in the territorial jurisdiction of this United States District Court for the Southern District of California, Central Division, hereinafter sometimes referred to as Court, and that it has had its principal assets, both in extent and value, within the boundaries of said judicial district six months preceding January 28, 1938.

(2) That Debtor has not been adjudicated a bankrupt and no prior proceedings involving the sequestration of Debtor's assets is pending in any Court.

(3) That Debtor's principal assets consist of the ownership of all of the outstanding stock of Los Angeles Shipbuilding Company, formerly known as Los Angeles Shipbuilding and Drydock Corporation, hereinafter referred to as "Shipbuilding Company." That said subsidiary corporation is engaged in the shipbuilding and ship repair work at Los Angeles Harbor, San Pedro, California. That neither the Debtor, nor any of its subsidiaries are utility corporations subject to the jurisdiction of the regulatory commission or commissions or other regulatory authority or authorities created by the laws of the State or States in which any properties of the Debtor or its subsidiaries are operated.

(4) That on or about January 28, 1938, Debtor herein filed its Petition for a Reorganization under and pursuant to the provisions of Section 77B of an Act of Congress approved July 1st, 1898, entitled "An Act to Establish a Uniform System of Bankruptcy Throughout the United States and Acts Amendatory Thereof and Supplementary Thereto" (said Act being hereinafter referred to as the "Bankruptcy Act" and said Section 77B being hereinafter referred to as "Section 77B"). That said Petition sets forth, among other things, the requisite jurisdictional facts, the nature of the business of Debtor, a brief description of the assets, liabilities

and financial condition of the Debtor, and that Debtor did not have sufficient funds with which to meet and pay the obligations of Debtor set forth in said Petition and affected by the Plan of Reorganization, hereinafter mentioned. That attached to said Petition as Exhibit "E" was a Plan of Reorganization proposed by the said Debtor. That on January 28, 1938, an order of the Court was entered herein on said Petition, approving the said Petition as properly filed under Section 77B, continuing the Debtor in possession and control of its properties, pending a hearing on said Petition, providing for the time and place of said hearing and the parties to whom and the manner in which notice of hearing should be given, providing for the filing of claims and objections thereto and classifying the creditors of the Debtor whose interest would be affected by said Plan of Reorganization.

(5) That on February 28, 1938, said Petition came on for hearing pursuant to said Order of January 28, 1938, before this Court and the matter was continued to March 21st, 1938. The Court announced in open court on February 28, 1938, that in view of the heavy congestion of the Court's trial calendar, and that questions of fact too numerous, requiring too much time to be considered by the Court in sufficient detail were necessary to be heard and determined in order to enable this Court to properly and equitably decide all issues which have been or may be raised herein, it would, therefore, appoint Reuben G. Hunt as Special Master for the purpose of hold-

ing hearings as required by Section 77B. That the minute order appointing said Special Master is dated February 28, 1938. The formal written order of reference was signed on March 2, 1938, and filed herein on March 3rd, 1938, requiring all parties interested herein to submit to the said Special Master any and all answers, pleadings, objections and authorizing, empowering and directing the Special Master to hold hearings as required by the Act and by Order of Court and to submit to this Court his findings of fact, together with any recommendations which he might see fit to make.

(6) That on or about March 18th, 1938, pursuant to Order of Court, a modification of the Plan of Reorganization was proposed and filed herein by Debtor. That pursuant to Order of Court a copy of said modification of said Plan, together with a notice of a hearing thereon to be held on April 11, 193.., in the court room of the undersigned Judge of this Court was mailed on March 31, 1938, to the last known addresses of all known creditors and stockholders of Debtor. That said modification of said Plan does not adversely affect the rights of Debtor's Bondholders under said Plan; that none of said Bondholders withdrew their consent to said Plan; that Debtor's Class A shareholders are adversely affected by said modification; that by the terms of said notice approved by this Court mailed to each of said Class A shareholders it was provided that they could withdraw their consent to said Plan on or before April 11, 1938; that if their consent to

said Plan was not withdrawn by said date they would be deemed to have consented to said modification; that none of said Class A shareholders withdrew their consent; that Class A shareholders holding 52,298.14 shares of said Class A stock, representing 82+% of all of said stock issued and outstanding filed with the Security-First National Bank of Los Angeles their written consent to said modification.

(7) That on or about April 9th, 1938, Reuben G. Hunt, Special Master, filed his report herein, showing, among other things, that hearings were held before him on March 3rd, 4th, 8th, 10th, 11th, 16th, 17th, 18th and on April 8th, 1938, on the said Plan of Reorganization, upon objections filed thereto and on matters set forth in the order of reference; that the following appearances were made before him:

Faries & McDowell by David R. Faries and J. Clifford Argue and Gibson, Dunn & Crutcher by J. C. Macfarland for the Debtor.

George R. Larwill and Frank S. Balthis, Jr., for Thomas A. Ogden, May Justice Johnson, Mary O. Rivers, Edwin M. and Maude M. Rankin, C. W. Olsen, Helen Avery Cameron, Emma L. Rooks, William Wildburger, Merritt W. Linscott and Anna Edge Linscott, bondholders holding Thirty-three Thousand ($33,000.00) Dollars, principal amount of bonds.

Thomas K. Case in propria persona, bondholder, holding Thirteen Thousand Five Hundred ($13,500.00) Dollars, principal amount of bonds.

Clarke & Bowker by Robert M. Clarke and Earl E. Moss for Adele M. Cowan, bondholder holding Five Thousand ($5,000.00) Dollars, principal amount of bonds.

William Schoenau, Jr. in propria persona, bondholder, holding Twelve Thousand Five Hundred ($12,500.00) Dollars, principal amount of bonds.

Overton, Lyman & Plumb by C. L. McGaughey for Charlene Coulter and Mary E. Priest, bondholders holding Fourteen Thousand Five Hundred ($14,500.00) Dollars, principal amount of bonds.

That said Special Master's Report is hereby approved by this Court and the findings of fact contained therein are hereby adopted as the findings of this Court as fully as though set forth herein at length, except:

(a) In said Special Master's Report the recommendation is made that a permanent trustee should be appointed herein for the Debtor corporation to act during the proceedings herein and in this connection this Court's conclusion and finding is at variance with that of the Special Master and the Court finds that it will be for the best interests of all parties in interest that the Debtor continue in possession of all of its property, subject to the order of this Court during the pendency of this proceeding and that this is in accordance with the provisions of the Plan.

(b) The Special Master, at pages 23 and 46 of said report has erroneously described the provisions of the Plan with respect to the election of a board

of directors of the new company, although at page 26 of his findings the Special Master has correctly set forth the provisions of the Plan which are that the board of directors of the New Company, upon its organization, shall consist of seven members, being six members of the present board of directors of the debtor and George R. Larwill, one of the attorneys representing certain intervening bondholders in this proceeding and such board shall hold office until their successors are elected at a meeting of the stockholders of the new company, which meeting shall be held within a period of ninety days from and after the date of the incorporation of the new company, or in the event that such meeting cannot be held within such period, then within such further extension of time as may be provided by order of this Court and the new company shall take no part in the election of the Board of Directors, except that prior thereto it shall send out a formal notice thereof and a proxy in usual form, but without designation of a proxy holder, together with a letter urging all stockholders to be present in person, or to designate someone as their proxy and any and all persons who desire to be elected a director of the new company at such meeting shall solicit votes and proxies entirely at such person's own expense.

(c) The Special Master, at page 32 of said Report, found that there were outstanding 57,065.165 shares of Class "A" stock of Debtor. The Allen C. Stelle claim for 722.35 shares of Class "A" stock filed herein on March 15, 1938, has been allowed by

order of this Court dated July 13th, 1938, and a certificate evidencing said shares has been issued pursuant to said order since the date of said Special Master's Report, thereby increasing the number of outstanding shares of Class "A" stock of Debtor to 57,788 shares.

(d) Insofar as said findings in said Special Master's Report are otherwise inconsistent with the Plan and the findings of this Court as specifically set forth herein.

(8) That Debtor is a holding corporation, owning and holding all of the outstanding shares of the capital stock of the following corporations, excepting certain qualifying shares held by directors of said corporation, the equitable ownership of which actually is in the debtor.

a. Los Angeles Shipbuilding Company, formerly known as Los Angeles Shipbuilding and Drydock Corporation, is a corporation organized and existing under the laws of the State of California.

b. Masset Timber Company, Ltd., a corporation organized and existing under the laws of the Province of Canada.

c. Puget Sound Lumber and Box Company, a corporation organized and existing under the laws of the State of Washington.

d. Pacific Wirebound Box Company, a corporation organized and existing under the laws of the State of California.

e. Western Marine Supply Company, a corporation organized and existing under the laws of the State of California.

f. Los Angeles Lumber Products Steamship Company, a corporation organized and existing under the laws of the State of California.

(9) That Shipbuilding Company is a corporation organized and existing under the laws of the State of California; that its principal place of business is and has been for more than six (6) months prior to January 28, 1938, in the City of Los Angeles, County of Los Angeles, State of California.

(10) That Debtor's principal asset consists of the ownership of all of the capital stock of said Shipbuilding Company; said Shipbuilding Company is engaged in the shipbuilding and ship repair work at Los Angeles Harbor, San Pedro, California, and has substantial assets and earning possibilities, its fixed assets are subject to the lien of a Trust Indenture dated March 8, 1924 (Debtor's Exhibit "E" in evidence, as modified by supplemental indentures Debtor's Exhibits: "F," "G" and "H" in evidence) securing the payment of bonds upon which there is now owing a great deal more than the value of such assets. Said shipbuilding Company has only current debts of small amount besides the lien of said bonds; that the current debts are not affected by the Plan but will be paid in the ordinary course of business. It has current assets not subject to the lien of said bonds which have a value of approximately $400,000.00. The value of said Shipbuilding Company's fixed assets is $480,000.00. The total value of all assets of said subsidiary is $830,000.00.

(11) That Debtor's subsidiaries Pacific Wirebound Box Company, Western Marine Supply Com-

pany and Los Angeles Lumber Products Steamship Company, have no tangible assets of any kind. That said companies have not operated since 1925. That they represent an annual expense to Debtor and have no value to the efficient operation of Debtor's business. That it is desirable that these companies be dissolved.

(12) That Debtor's subsidiary, Masset Timber Company, Ltd., owns twenty-four licenses issued by the Government of the Province of British Columbia, Canada, comprising approximately 12,000 acres of timber land on Graham's Island in British Columbia, Canada. That it owns in fee simple lots 1497, 1498 and 444, Queen Charlotte District, Province of British Columbia, thereupon are located certain buildings, wharves and docks. That the Masset Timber Company, Ltd., has been a financial failure and a great expense to Debtor. That the property of said subsidiary company has no present market value.

(13) That Debtor's subsidiary, Puget Sound Lumber and Box Company, owns certain real estate, buildings, wharves and docks comprising the saw mill and box factory units located on Lake Union in Seattle, Washington. That said property has a water frontage of approximately 700 feet. That lumber operations at said plant have resulted in heavy losses. That said company has not operated since 1925. That the City of Seattle has extended its residential district to within short distances of the property and has zoned the property against a resumption of its former operations. That the saw mill

building, originally erected at great cost, is specially constructed and unfit for other purposes. That the water adjacent to the dock is of insufficient depth to permit commercial vessels of average draft to moor thereto for the discharging or unloading of cargo. That said docks and piers are in need of extensive repairs, necessitating the expenditure of sums in excess of their worth. That the property has value only as real estate and is worth not in excess of $40,000.00.

(14) That the estimated annual expense of maintaining the Debtor corporation and its subsidiaries in existence is Twenty-one Thousand Five Hundred ($21,500.00) Dollars. That the expenses of maintaining said corporations and their properties have been paid for many years from the earnings of the Shipbuilding Company.

(15) That in brief Debtor's assets, other than the stock of its subsidiary corporations consist of:

(a) Cash	$1,187.27
(b) Accounts Receivable, collectible	5,199.50
(c) Sinking Fund Account	3,070.80
(d) Leasehold interest in 68.54 acres of water frontage at Los Angeles Harbor, under lease from the Harbor Department of the City of Los Angeles, a Municipal Corporation, carried on the books of the corporation at a value of	1.00

This leasehold has no realizable value for creditors in the event of liquidation.

(16) That Debtor's liabilities consist of principal and interest amounting to some Three Million Eight Hundred Seven Thousand and Seventy-one and 88/100 ($3,807,071.88) Dollars upon first lien bonds issued March 8, 1924, secured by a mortgage or Trust Indenture which covers the fixed assets of the Shipbuilding Company and the capital stock of the subsidiaries and upon which no interest has been paid since February 1st, 1929.

(17) That at the date of the institution of these proceedings under Section 77B, the Debtor was at all times and since has been unable to meet its debts as they mature.

(18) That Debtor is insolvent both in the equity sense, that is, it is unable to pay its debts in the ordinary course of business as they mature, and in the bankruptcy sense, that is, its assets at a fair valuation thereof based upon appraisal and audit reports introduced in evidence in this proceeding are insufficient to pay its debts.

(19) That Debtor's issued and outstanding capital stock, consists of 57,788 shares Class "A" and 5,112 shares of Class "B," both of said classes of shares being without par value.

That there is no difference between the Class "B" and the Class "A" shares of Debtor except that the Class "A" shares are entitled to a preference of $400,000.00 on liquidation, together with interest thereon from April 1, 1930, until paid, over the Class "B" shares, which amount, according to the Articles of Incorporation of the Debtor, shall be

paid on account of said Class "A" shares before any amount shall be paid on Class "B" shares.

(20) The present stockholders of Debtor, holding Class "A" shares, comprise some of those who were stockholders prior to the 1930 reorganization of Debtor or their successors in interest. The financial investment from the beginning, of these stockholders, or their predecessors in interest, and the bondholders, has been approximately equal in the sum of Two Million Five Hundred Thousand ($2,500,000.00) Dollars for each class. At the time of the amendment of the Trust Indenture securing Debtor's Bonds referred to in Paragraph 23 hereof the assets then remaining were worth approximately Four Hundred Thousand ($400,000.00). If the bonds had been then foreclosed without such reorganization, said sum is about the maximum that the bondholders would have received. As a part of said reorganization the stockholders paid in Four Hundred Thousand ($400,000.00) Dollars in cash to permit the corporation to continue its business and in order to secure a release of stockholders liability.

(21) That the Class A shareholders have had the management and control of Debtor and have the right to its management and control until the maturity of said bonds in 1944 subject to the jurisdiction and control of this Court in the above entitled proceeding.

(22) The bonds of Debtor are owned by approximately 757 individuals who are widely scattered and unorganized. It will be beneficial to the bondholders

to allow the Class A shareholders to participate in this reorganization so as to provide continuity of management.

(23) That it will be an asset of value to the new Company and its shareholders to retain Debtor's present Class A shareholders as shareholders of the New Company because of their familiarity with the operation of the business of Debtor and its subsidiary Shipbuilding Company, and because of their financial standing and influence in the community.

(24) In April, 1930, a supplement to the Trust Indenture of March, 1924, was duly and regularly executed in accordance with Section 11, Article 9 thereof. That said supplemental Trust Indenture was executed with the consent of 97% of the face value of all bonds outstanding and is binding upon all bondholders whether they consented to the execution of such supplemental Trust Indenture or not. That among other things by virtue of such supplemental Trust Indenture interest on said bonds was reduced from 7½% to 6%, payable only out of earnings. The payment of interest was waived unless earned until 1944. That for all practical purposes said bonds cannot be foreclosed until they mature in 1944. That said supplemental indenture and all provisions thereof, is effective and binding upon all holders of Debtor's bonds.

(25) That the principal valuable consideration passing between the bondholders and the stockholders to justify participation of stockholders in the Plan is the virtual abrogation of said agreement de-

ferring foreclosure until 1944.

(26) That if the bondholders were able to foreclose now and liquidate Debtor's assets, they would receive substantially less than the present appraised value of Debtor's assets.

(27) That the bondholders cannot now foreclose, nor can they acquire the assets securing Debtor's bonds, or obtain control of Debtor without long and protracted litigation which would undoubtedly involve an appeal to the Supreme Court of the United States and would be expensive and of great injury to Debtor as a going concern.

(28) That bonding companies are unwilling to assume the risk of becoming surety for Debtor or its subsidiary Shipbuilding Company because of the outstanding bond issue. That without the ability to obtain surety bonds, bids cannot be made on the building of new ships and operations are restricted to small repairs.

(29) That the United States Government is planning the construction, for its navy, of many warships and auxiliary vessels, the latter including mine sweepers, oil tankers, freighters, coast guard cutters and similar ships. That the shipyard of Debtor and its subsidiary Shipbuilding Company are equipped for and capable of building certain of said ships. That by reason of said shipbuilding program valuable opportunities are open to Debtor and its subsidiary Shipbuilding Company in the building of ships which will be lost to Debtor, its bondholders and other interested parties, if litigation is commenced and if the Plan is not approved.

(30) That the value to the bondholders of maintaining Debtor as a going concern, and of avoiding litigation, is in excess of the value of the stock being issued to said Class A shareholders under said Plan.

(31) That by said Order, entered January 28th, 1938, this Court directed that there shall not be required to be filed herein as provided by Subdivision (c), Clause (1) of Section 77B a statement showing what, if any, claims and shares of stock have been purchased or transferred by those accepting the Plan prior to the commencement of or in contemplation of these proceedings and the circumstances of such purchase or transfer as this Court is satisfied. That by reason of the number of securities of Debtor and the extent of the public dealing therein, the preparation of such a statement would be impractical.

(32) Pursuant to the petition of the Debtor filed herein on January 28, 1938, an order of this Court was made and filed herein on January 28, 1938, determining the time, form and manner of filing and evidencing claims and interests, classifying creditors and stockholders of the Debtor into classes according to the nature of their respective claims and interests, fixing March 15, 1938, as the last day upon which claims against the Debtor must be filed, and ordering that the Debtor or any stockholder or creditors of the Debtor might object to the allowance as a whole or in part of any claims filed in this proceeding by filing an objection to the allowance of such claim with the Clerk of this Court on or be-

fore March 21, 1938, and providing that written notice of any such objection should be given to the claimant and to the Debtor by serving the same upon its counsel of record in this proceeding, and providing that the Debtor, the objecting party or the claimant might apply to this Court for a hearing upon any such objection, all as provided and ordered in said Order dated January 28, 1938. Said Order of January 28, 1938, provided that all claims in respect of which no objections shall have been filed or otherwise made in accordance with said Order would be deemed finally allowed, except as this Court should by order thereafter direct. The Court has caused reasonable notice of said Order to be given to creditors and stockholders by publication and by mailing a copy of said notice as provided in said Order to each known creditor and stockholder and each person affected by said Order. That at the hearing held on March 21, 1938, and subsequent hearings held pursuant to continuances ordered by this Court, opportunity was given to creditors and stockholders and all interested parties to be heard on the division of creditors and stockholders of Debtor into classes according to the nature of their respective claims and interests, made by this Court under its order of January 28, 1938; that the Court considered the objections filed thereto by Thomas K. Case and overruled the same, and that no other objections were made to said division.

(23) Pursuant to Order of this Court, entered herein on January 28, 1938, Debtor has filed herein

such schedules and has submitted herein such other information as is necessary to disclose the conduct of the Debtor's and its subsidiaries' affairs and the fairness of the proposed Plan of Reorganization. That claims and evidences of interest have been filed herein on behalf of all bondholders by the Security-First National Bank of Los Angeles, as Trustee, and on behalf of stockholders by the Debtor as shown on the claims on file herein; that no objections have been filed or made to the allowance of any of said claims.

(34) That on February 13, 1937, application was made by Debtor to the Commissioner of Corporations of the State of California for authority to submit said Plan to its bondholders and stockholders. That a hearing was had on said application after notice to all creditors and stockholders and a finding was made that the terms and conditions of the proposed issuance of certificates of deposit are fair, and a permit was issued, dated June 14, 1937, by said Commissioner, authorizing the solicitation of bondholders for their approval of said Plan. That the Plan as originally filed herein was the same Plan so approved by the Corporation Commissioner of the State of California.

(35) That the Plan has been duly proposed by Debtor herein in accordance with the provisions of Section 77B, and no other Plan for the reorganization of the Debtor, or any amendment to said Plan or modification thereof, except that mentioned in Paragraph 6 thereof, was proposed.

(36) That the only creditors and stockholders of Debtor affected by said Plan of Reorganization were and are as follows:

(a) Holders of Debtor's outstanding First Lien and Collateral Trust Twenty Year 7½% Sinking Fund Gold Bonds, hereinafter referred to as bonds, issued March 8th, 1924, of which Two Million Five Hundred and Sixty-five Thousand Five Hundred ($2,565,500.00) Dollars in principal amount remain outstanding, and upon which no interest has been paid since February 1st, 1929.

(b) 57,788 shares of Class A stock.

(c) 5,112 shares of Class B stock.

(37) That creditors of the Debtor, other than those herein designated, are not affected by said Plan of Reorganization and the Court has not required that such creditors file claims herein as the obligations of Debtor to such creditors have been and will be paid as they mature.

(38) That under the Plan and by Order of this Court entered January 28, 1938, for the purpose of the Plan and its acceptance, creditors and stockholders of the Debtor were divided into classes according to the nature of their respective claims and interests as follows:

Class I: The holders of Debtor's 7½% Sinking Fund Gold Bonds.

Class II: The holders of Debtor's Class A stock.

Class III: The holders of Debtor's Class B stock.

That pursuant to Order of this Court dated January 28, 1938, reasonable notice was given of such

division of creditors into classes for the purpose of the Plan, as hereinbefore in Paragraph (30) set forth.

(39) That acceptances in writing in form as heretofore and hereby approved by this Court have been filed with the Security-First National Bank of Los Angeles, as Trustee, and in these proceedings by or on behalf of creditors and stockholders whose claims have been allowed and as classified, showing that the Plan has been duly accepted as follows:

Class I: By holders of Two Million Three Hundred and Three Thousand ($2,303,000.00) Dollars principal amount of Debtor's bonds, specified under Class I above, said amount is 89+% of the principal amount of all outstanding of Debtor's bonds.

Class II: By holders of 56,920.180 shares of Debtor's Class A stock, representing ninety-eight plus percent of all of said outstanding Class A stock.

Class III: By holders of Four Thousand Five Hundred and Ninety-nine shares of Class B stock of Debtor, representing eighty-nine plus percent of all outstanding Class B shares.

(40) Notice as required to be given of hearings by the Orders duly made and entered herein on January 28, 1938, and March 21, 1938, have been given in compliance with said Orders, and all creditors and stockholders of Debtor, all parties to this proceeding and all interested parties herein had due notice and an opportunity to be heard with respect to the confirmation of the Plan, and to make objections to the Plan and its confirmation, and

Debtor has moved for the confirmation of the Plan. The Court is satisfied and finds that:

(a) All proceedings taken by Debtor and its board of directors in the preparation and submission of said Plan and for its approval and confirmation have been taken in good faith;

(b) The Plan is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders of the Debtor and is feasible;

(c) The Plan complies with the provisions of Subdivision (b) of Section 77B, and all other applicable provisions of Section 77B;

(d) The Plan has been accepted as required by the provisions of Subdivision (e), Clause (1) of Section 77B and all other applicable provisions of Section 77B;

(e) The provisions of Subdivision (e), Clause (2) of Section 77B are not applicable for the reason that Debtor is not a utility subject to the jurisdiction of a regulatory Commission or Commissions or other regulatory authorities of the State of California in which the properties of the Debtor are operated;

(f) All amounts to be paid by the Debtor for services or expenses incident to the reorganization are to be subject to the approval of this Court;

(g) The offer of the Plan and its acceptance are in good faith and have not been made or secured by any means or promises forbidden by the Bankruptcy Act;

(h) The Debtor and every other corporation issuing securities or acquiring property under the

Plan is authorized by its Charter or by applicable State or Federal laws, upon confirmation of the Plan, to take all action necessary to carry out the Plan;

(i) That Debtor has no executory contract or unexpired lease of real estate which is to be rejected under the Plan.

(41) The officers of Debtor are paid no salaries; that the principal officers of the subsidiary Shipbuilding Company are C. C. Spicer, President, whose salary is $1,000.00 per month; J. B. Ingoldsby, whose salary is $400.00 per month, and George B. Southerland, whose salary was $600.00 per month through April, 1938, and was increased to $750.00 per month commencing as of May 1, 1938, with the approval of the court by its minute order of May 31, 1938. That all of said officers are capable and experienced men and that the salaries paid them are reasonable. That it is for the best interests of Debtor and all parties affected by the Plan, that the order allowing Debtor to remain in possession of its business and assets be made permanent.

(42) That notices of the hearing for the purpose of determining whether Debtor should remain in possession of its property and assets and for a consideration of and confirmation of the Plan were duly given in the manner provided by Order of this Court, entered on January 28, 1938, and that the Debtor and all creditors and stockholders of the Debtor and all other interested parties have had full opportunity to be heard on the proposed confirma-

tion of the Plan, to make objections to the Plan and to be heard upon all of the matters specified in the notice of such hearing. That evidence sufficient and satisfactory to this Court has been presented with respect to the assets and liabilities of the Debtor and of its subsidiaries and with respect to various matters and factors involved in connection with the formulation of the Plan and with respect to the Plan and all other matters determined or adjudicated by this Order.

(43) That this Court has exclusive jurisdiction of the Debtor and of its subsidiaries and of the property of the Debtor and of the property of its subsidiaries, wherever located for the purpose of these proceedings under Section 77B and has jurisdiction to make the findings, orders, adjudications and decrees contained in this Order.

(44) That this Court did, on May 12th, 1938, make and enter its order in this proceeding as an interlocutory order confirming the Plan, and that said order was in the form of an interlocutory order at that date due to and in accordance with the provision contained in subdivision (7) of paragraph (f) of Section 77B of the Bankruptcy Act, which provision reads as follows:

> "(7) The Debtor, and every other corporation, issuing securities or acquiring property under the Plan, is authorized by its Charter or by applicable State or Federal Laws, upon confirmation of the Plan, to take all action necessary to carry out the Plan, and that, in case the

Debtor is a utility corporation subject to the jurisdiction of a regulatory commission or commissions or other regulatory authority or authorities, created by the laws of the State or States in which the properties of the Debtor are operated, all authorizations, approvals or consents of each such commission or authority required by the laws of such State or States, have been obtained."

That by said order of May 12, 1938:

(1) The Plan was confirmed subject to the requirement that the Debtor and its board of directors should, in the manner provided by law, create or cause to be created the New Company, as provided in the Plan, which New Company should take all steps in the manner provided by law to authorize the issuance of the new securities described in the Plan, and the New Company should make application to, and obtain a permit from, the Commissioner of Corporations of the State of California to issue the new securities under the Plan, and that satisfactory proof should be presented to this Court to the effect that said New Company had been duly created and was authorized by its Charter or by applicable State or Federal laws, upon confirmation of the Plan, to take all action necessary to carry out the Plan, and that said securities had been duly authorized, and that said permit had been granted by said Commissioner to said New Company, all in accordance with the Plan and in the manner pro-

vided by law, and that thereupon this Court would make and enter its order of final confirmation of the Plan.

(2) The provisions of the Plan and said order of May 12, 1938, were made binding upon the Debtor and stockholders of the Debtor, and all creditors of the Debtor, secured or unsecured, whether or not affected by the Plan and whether or not their claims had been filed and if filed, whether or not approved and allowed, including the stockholders and creditors who had not, as well as those who had, accepted the plan.

(3) Until this Court should provide otherwise, the Debtor should continue to have all of the title and should exercise, subject to the control of this Court, all of the powers vested in such Debtor by statute and by orders of this Court previously entered herein, and that the Debtor should, upon the further order of this Court, file with this Court a "Debtor in Possession" bond in such penal sum as this Court might direct, conditioned upon the faithful performance of its duties herein, and that the form of said bond should be first submitted to Reuben G. Hunt, Special Master, for his approval and thereafter be subject to the approval of this Court.

(4) Until further order of this Court, Debtor should pay no salaries to its officers; Debtor's subsidiary shipbuilding company, should, and it was, by said order of May 12, 1938, authorized and directed to, pay to its officers mentioned in paragraph 41 of

said Order of May 12, 1938, the salaries therein set forth.

(5) The Debtor should pay to and/or for the account of the New Company all actual expenses in connection with the carrying out of the Plan, as follows:

Filing fee and other charges of the Secretary of State of the State of California, and recording fees of the County Clerk of the County of Los Angeles, where the Articles of Incorporation of the New Company were to be filed; all printing and other incidental expenses in connection with the creation of the New Company and the authorization of the issuance of the new securities; the filing fees and any other expenses in connection with the obtaining of the necessary permits from the Commissioner of Corporations of the State of California and printing of the new securities.

(6) All the claims filed herein have been settled and compromised with the approval of the Court, or finally allowed.

(7) All objections to the Plan of Reorganization and objections to the order of this Court classifying creditors and stockholders of the Debtor into classes, according to the nature of their respective claims and interest, and objections to the jurisdiction of this Court filed by Thomas K. Case and other objecting bondholders and their exceptions to the Special Master's report were, by said order of May 12, 1938, overruled.

(8) The Court, by its said order of May 12, 1938, specifically reserved jurisdiction:

(a) To make further orders in connection with, and to supervise and control the putting into effect and the carrying out of, the Plan and final confirmation thereof, including the giving of such directions, authorization, or approval as the Court might determine in regard to the New Company; the making or joining in by the proper parties of an instrument or instruments of authorization and conveyance; the incorporation of the New Company referred to in the Plan; the authorization, creation and issuance of the new securities described in the Plan, and the delivery of said new securities in exchange and payment for the proper assets of the Debtor, in accordance with the Plan, and the delivery of the new securities called for by the Plan to the creditors of the Debtor; to consider and pass upon the form, execution, and delivery and sufficiency of all documents to be executed in connection with the consummation of the Plan and the taking of all other proceedings or action, and the giving of all directions to the Debtor, the New Company, and all other interested parties or persons which might be necessary or proper in order to consummate the Plan and effectuate its substance and intent.

(b) To fix and direct the payment of administrative expenses and allowances and to allow reasonable compensation for the services rendered and reimbursement for the actual and necessary expenses incurred under or in connection with these proceedings and in connection with the Plan by officers, parties in interest, trustees, depositaries, and

the attorneys or agents of any of the foregoing or of the creditors or of the Debtor.

(c) To make such provision as might be equitable, by way of injunction or otherwise, to discharge the Debtor, from its debts or liabilities and to end all rights or interests of stockholders, creditors, or claimants except as provided in the Plan or as might, consistent with the provisions of the Plan, be reserved under the order or orders directing the transfer and conveyance of the estate, property, and assets of the Debtor to the New Company.

(d) To hold hearings on Debtor's petition for tax bar order, and to make such order or orders as the Court might deem necessary or proper in connection therewith.

(e) To enter a final decree closing the case.

(f) Generally, to determine any and all matters pertaining to this order, or to the Plan, not determined prior to said order or by said order of May 12, 1938.

(9) The Court, by said order of May 12, 1938, directed that the Debtor report to this Court in its Courtroom in the Pacific Electric Building, at the corner of Sixth and Main Streets, Los Angeles, California, on May 31, 1938, at two o'clock P. M. of said day, or as soon thereafter as counsel might be heard, with respect to its compliance with said order, and the Court directed that at that time it would pass upon such matters in this proceeding as might be presented to it, or as to which the Court had reserved jurisdiction by said order of May 12,

1938, or any prior order made herein. Said order of May 12, 1938, provided that service of a copy of said order of May 12, 1938, on or before May 18, 1938, upon the attorneys for all parties who have appeared in this proceeding and publication of a notice thereof in substantially the form attached to said order of May 12, 1938, in the Los Angeles Daily Journal on May 18, 1938, would be reasonable and sufficient notice of said hearing to be held on May 31, 1938, and that said hearing to be held on May 31, 1938, might be adjourned without further notice except by announcement at said hearing, unless the Court should otherwise direct.

(45) That said hearing set for May 31, 1938, pursuant to said order of May 12, 1938, was adjourned and continued by public announcement from time to time until ten o'clock A. M. of June 13, 1938, at which time the Debtor submitted its report to this Court, as ordered under said order of May 12, 1938, and included in said report as exhibits a copy of the Articles of Incorporation of Los Angeles Shipbuilding and Drydock Corporation, the New Company organized pursuant to the Plan of Reorganization, and copies of the form of its Preferred and Common Share Certificates, copy of its By-Laws, copy of the minutes of the first meeting of its Board of Directors, held May 23, 1938, and a copy of the permit dated June 9, 1938, issued to said New Company by the Commissioner of Corporations of the State of California, authorizing it to issue the securities called for by the Plan. That thereafter there was filed in this proceeding by Debtor a copy of application, dated May 31, 1938,

made by said Los Angeles Shipbuilding and Drydock Corporation to the Commissioner of Corporations of the State of California, pursuant to which said permit, dated June 9, 1938, was granted together with a copy of resolution adopted by the board of directors of said Los Angeles Shipbuilding and Drydock Corporation on June 23, 1938, authorizing the issuance of the securities called for by the Plan, pursuant to said permit dated June 9, 1938. That Los Angeles Shipbuilding and Drydock Corporation, the New Company provided for in the Plan, was incorporated under and in accordance with the laws of the State of California by the filing of its Articles of Incorporation in the office of the Secretary of State of the State of California on May 19, 1938, and a copy of said Articles, certified by the Secretary of State of the State of California, was filed in the office of the County Clerk of the County of Los Angeles on May 23, 1938, wherein the principal office for the transaction of business of said New Company is located, and this Court approves the provisions of said Articles of Incorporation and finds that they comply with the Plan. That the application of said New Company to issue the securities called for by the Plan, which was filed with the Commissioner of Corporations of the State of California and the permit dated June 9, 1938, of the Commissioner issued pursuant thereto, are hereby approved by the Court, and the Court finds that said permit authorizes the issuance of the securities in accordance with said application and the Plan, subject to the conditions set forth in said permit, as follows:

"(a) That the securities herein permitted to be sold and issued shall not be executed and delivered until the Plan of Reorganization set forth in the application shall have been confirmed by order of the District Court in the Reorganization Proceedings described in the application, and either:

"(1) Thirty (30) days shall have elapsed after the entry of said order confirming said Plan of Reorganization, and during said thirty days no application for leave to appeal from said order confirming said Plan shall have been made to the United States Circuit Court of Appeals for the Ninth Circuit; or

"(2) In the event an application for leave to appeal from said order confirming said Plan shall have been filed in said Circuit Court of Appeals within thirty days from the date said order confirming said Plan is entered in the Reorganization Proceedings, application for leave to appeal shall have been denied by order of said Circuit Court of Appeals; or

"(3) In the event an application for leave to appeal from said order confirming said Plan shall have been filed in said Circuit Court of Appeals during such thirty days and leave to appeal shall have been granted by order of said Circuit Court of Appeals, the order confirming said Plan shall have been affirmed by order of said Circuit Court of Appeals or such appeal shall have been dismissed.

"(b) That unless revoked, suspended or extended by alteration or amendment, upon application filed on or before the date of expiration specified in this condition and upon such terms and conditions as the Commissioner may deem proper, all authority to sell securities under issuance clauses 1 and 2 of this permit shall terminate and expire on the 8th day of June, 1940. All other issuance clauses and/or conditions of this permit shall remain in full force and effect until revoked, suspended, altered or amended by appropriate order of the Commissioner."

That the resolution of the Board of Directors of of the New Company, copy of which has been filed herein, authorizing the issuance of the securities provided for in the Plan, is hereby approved and the Court finds that said Resolution properly authorizes the issuance of the new securities provided for in the Plan.

(46) That due and reasonable notice of all hearings had herein has been given as required in said Section 77B and by order of this Court.

(47) The Debtor and every other corporation issuing securities or acquiring property under the Plan is authorized by its Charter, or by applicable State or Federal laws, upon confirmation of the Plan by this order, to take all action necessary to carry out the Plan, subject to, and upon compliance with, the conditions set forth in said permit, dated

June 9, 1938, of the Commissioner of Corporations of the State of California.

It is therefore ordered, adjudged, and decreed as follows:

(1) Satisfactory proof has been presented to this Court that Los Angeles Shipbuilding and Drydock Corporation, the New Company provided for in the Plan, has been duly created; that all steps to authorize the issuance of the securities provided for in the Plan have been taken in the manner provided by law, and that the issuance of said new securities has been duly authorized by said New Company by action of its Board of Directors, and that a permit of the Commissioner of Corporations of the State of California to said New Company, authorizing the issuance of said securities in accordance with the Plan, has been duly issued to Los Angeles Shipbuilding and Drydock Corporation, the New Company provided for in the Plan; that said New Company is authorized by its Charter and by all applicable State and Federal Laws to take all action necessary to carry out the Plan; that the condition imposed in the Interlocutory Order of this Court confirming the Plan, dated May 12, 1938, has been complied with and the Plan should be, and hereby is, finally confirmed and the order of this Court, dated May 12, 1938, should be and hereby is in all respects ratified and confirmed.

(2) The Court hereby approves the Articles of Incorporation and the By-Laws of Los Angeles Shipbuilding and Drydock Corporation and the

form of proposed stock certificates for its Preferred and Common Capital Stock, and this Court also approves the designation of

C. C. Spicer—as President and Director
W. W. Powell—as Director
H. K. Bagley—as Director
Milo A. Baker—as Director
Harry W. Watson—as Director
David R. Faries—as Vice-President and Director
George R. Larwill—as Director
J. B. Ingoldsby—as Secretary and Treasurer; and
J. C. Argue—as Assistant Secretary,

of Los Angeles Shipbuilding and Drydock Corporation.

(3) That all objections to the Plan are hereby overruled and the Debtor, its subsidiaries, and the Security-First National Bank of Los Angeles and W. N. Bucklin, Jr., as Trustees under the Trust Indenture securing Debtor's bonds, Security-First National Bank of Los Angeles, as Trustee under Trust Agreement dated April 1, 1930, and as the Distributing Agent hereinafter designated and appointed, and as Depositary under the Plan, are hereby authorized and directed to put into effect and to carry out the Plan in accordance with the provisions thereof and of this order and of any further orders of this Court under and subject to the supervision and control of this Court.

(4) The Security-First National Bank of Los Angeles is hereby appointed to act as Distributing Agent for and on behalf of Debtor and the New Company for the purpose of delivering or distributing to the persons entitled thereto 641,375 shares of Preferred stock of the New Company and proceeds arising from liquidation of properties of subsidiaries, in exchange for bonds and Trust Certificates representing bonds of the Debtor as hereinafter provided, and 188,625 shares of Common stock of the New Company in exchange for Debtor's Class "A" stock as hereinafter provided, and for the purpose of doing such other things as may be necessary in effecting the distribution of said stock and said proceeds in accordance with the Plan and this order.

(5) The property of the Debtor and of its subsidiary Los Angeles Shipbuilding Company, formerly known as Los Angeles Shipbuilding and Drydock Corporation, and now known as Los Angeles Ship Building Company, said name having been changed pursuant to the interlocutory order of this court heretofore entered in this proceeding (said company being hereinafter referred to as "Shipbuilding Company"), and the properties, if any, of its subsidiaries Pacific Wirebound Box Company, Western Marine Supply Company, and Los Angeles Lumber Products Steamship Company, when transferred and conveyed by Debtor and such subsidiaries to the New Company as hereinafter directed, shall be free and clear of all claims and

liens of the Debtor, its stockholders and creditors, including all purchasers claiming thereunder and without limiting the generality of the foregoing, free and clear of claims based on or arising out of ownership of the Debtor's Seven and One-half Per-cent Sinking Fund Gold Bonds, the lien of the mortgage or Trust Indenture securing said bonds, and based on or arising out of ownership of Trust Certificates representing said bonds.

(6) The provisions of the Plan and of this order shall henceforth be binding upon the Debtor, all stockholders of the Debtor, the subsidiaries and all stockholders of the subsidiaries, the trustee under Debtor's bond issue, the depositary under Debtor's Plan of Reorganization, and all creditors of the Debtor, secured or unsecured, whether or not affected by the Plan and whether or not their claims shall have been filed in these proceedings, and if so, filed, whether or not approved and allowed, including creditors and stockholders who have not accepted the Plan and those who have accepted it. The Debtor and the New Company and their respective Boards of Directors shall have general supervision of the consummation of the Plan, subject to the approval of this Court as provided in the Plan and this order. The New Company is hereby directed to carry out all of the terms and provisions of this order and subject to the provisions of the Plan, of Section 77B of the Bankruptcy Act, and of the orders of this Court entered herein from time to time to take any and all such

actions and to do such things as may be necessary, convenient or desirable fully to carry out and make effective the Plan.

(7) The Board of Directors of the New Company consist of seven members; being six members of the present Board of Directors of the Debtor and George R. Larwill, one of the attorneys representing certain intervening bondholders in this reorganization proceeding. Such Board of Directors shall hold office until their successors are elected at a meeting of the stockholders of the New Company, which meeting shall be held within a period of ninety (90) days from and after the date of incorporation of the New Company, or in the event that such meeting cannot be held within such period, then within such further extension of time as may be provided by order of this Court. The New Company shall take no part in the election of a Board of Directors, except that prior thereto it shall send out a formal notice thereof and a proxy in usual form but without designation of a proxyholder, together with a letter urging all stockholders to be present in person or to designate some one as their proxy. Any and all persons who desire to be elected a director of the New Company at such meeting shall solicit voters and proxies entirely at such person's own expense.

(8) Simultaneously with the delivery of the instruments provided for in Paragraph (10) of this order, the New Company shall and is hereby required to issue and deliver to and in the name of

Security-First National Bank of Los Angeles, as Distributing Agent, a certificate or certificates representing 641,375 shares of its Preferred Stock and 188,625 shares of its Common Stock for distribution as herein provided in exchange, respectively, for Debtor's bonds and for Debtor's Preferred Stock as provided for in the Plan. Such shares of stock shall be issued in the name of and delivered to the persons entitled thereto on the following basis:

(a) For each One Thousand Dollars ($1,000.00) principal amount of Debtor's bonds, the holder thereof shall receive two hundred fifty (250) shares of the Preferred stock of the New Company.

(b) The said Common Stock of the New Company shall be distributed on a prorata basis to the holders of Debtor's Class A stock.

(9) Security-First National Bank of Los Angeles, as Distributing Agent, is hereby directed from time to time to cause said shares of new Preferred Stock and new Common Stock issued and delivered to it pursuant to the foregoing paragraph (8) to be transferred into the names of the holders, respectively, of Debtor's bonds and Trust Certificates representing said bonds, and to the holders of Debtor's Class A Stock in the respective proportions as hereinbefore specified in Paragraph (8), upon the surrender to it of said bonds with coupons maturing August 1, 1929, and subsequently attached, Trust Certificates representing said bonds, and certificates representing Debtor's Class

A Stock, or upon surrender to it of Certificates of Deposit representing such bonds and appurtenant coupons, Trust Certificates representing such bonds and coupons, and such Class A Stock, issued by Security-First National Bank of Los Angeles, as Depositary under the Plan.

The Distributing Agent may, but shall not be obligated to, require such evidence of ownership or authority, such guarantees and indemnities and such letters of instruction as it may deem necessary to effect the distributions herein contemplated.

Holders of Debtor's bonds who tender such bonds for exchange for Preferred Stock of the New Company deliverable under the Plan without all unpaid appurtenant interest coupons, shall be entitled to receive such new Preferred Stock only upon indemnifying the Security-First National Bank of Los Angeles and W. N. Bucklin, Jr., as Trustees under the indenture securing said bonds, the Debtor and the New Company in such manner as such Trustees, the Debtor or the New Company may reasonably require against any liability in respect of such missing coupon or coupons, and the bonds to which they appertain shall be deemed to constitute a single claim against the Debtor, and holders of coupons not attached to said bonds (excepting coupons maturing prior to August 1, 1929, for which cash is retained by the Trustee pursuant to paragraph (13) of this order) shall not be entitled to receive stock of the New Company and cash issuable and payable to holders of Debtor's bonds under the Plan.

The New Company and the Distributing Agent may likewise issue and deliver Preferred Stock and Common Stock of the New Company to the owners of Debtor's bonds or Trust Certificates representing said bonds, and to the owners of Debtor's Class "A" Stock as herein provided, or Certificates of Deposit representing such bonds, Trust Certificates, or Class "A" Stock, whose bonds, Trust Certificates, certificates for Class "A" Stock, or Certificates of Deposit, as the case may be, have been lost or destroyed, upon the furnishing of evidence satisfactory to the Distributing Agent and to the New Company of the loss or destruction of such bonds, Trust Certificates, stock certificates, or Certificates of Deposit, and upon indemnifying Security-First National Bank of Los Angeles and W. N. Bucklin, Jr., as Trustees under the Trust Indenture securing such bonds, Security-First National Bank of Los Angeles, as Trustee under the Trust Agreement under which such Trust Certificates were issued, as Distributing Agent, as Depositary, the Debtor and the New Company as they may reasonably require against liability in respect of such lost or destroyed bonds, Trust Certificates, Stock Certificates, or Certificates of Deposit.

Any dividends which may be paid or declared in respect of Preferred and Common Stock of the New Company prior to the actual distribution thereof to persons entitled thereto under the Plan and this order, shall be paid to the Distributing Agent and by it paid to the respective distributees upon the

actual distribution of such Preferred or Common Stock of the New Company.

(10) Simultaneously with the delivery by the New Company to the Security-First National Bank of Los Angeles, as Distributing Agent, of the Preferred and Common Stock of the New Company as herein provided in paragraph (8), the Debtor and each of its subsidiaries (except as hereinafter in this paragraph provided) are hereby directed to assign, transfer, convey and deliver to the New Company all of the properties and assets of, the Debtor and of each such subsidiary, respectively, of every nature and description, tangible and intangible, real, personal or mixed, and wherever situated, including, but in nowise limited to all accounts receivable, choses in action, contracts, claims, and all rights, privileges, trademarks, trade names, and good will, by the execution and delivery of appropriate instrument or instruments of transfer and conveyance, and regardless of the actual date of such transfer and conveyance it shall be made as of July 1, 1938, and be deemed to have taken place on said date, and all transactions thereafter shall be treated as though done by the New Company and shall be reflected by the books of account of the New Company which shall be opened as of July 1, 1938.

The Debtor and each of its subsidiaries respectively shall join in the execution and delivery of such instruments of transfer and conveyance as may be deemed necessary to carry out the intent of

the order. From time to time Debtor and each such subsidiary respectively shall execute and deliver to the New Company such further assignments, transfers and conveyances of such properties and assets, including all trust deeds, conveyances, bills of sale, endorsements, checks or other instruments of transfer and conveyance, and all consents, requests, certificates or other documents or other instruments as the New Company may reasonably request, and the proper officers of the Debtor and the proper officers of each such subsidiary are hereby authorized and directed to execute and deliver or file in the name of the Debtor or on behalf of the Debtor or such subsidiary, but at the expense of the New Company, any and all such instruments so requested. Until the transfer of the property and assets as hereinabove provided, the Debtor and its subsidiaries may each continue to operate the respective properties of the Debtor and such subsidiaries remaining in the reorganization proceeding with all the rights, powers and authority heretofore and hereafter conferred upon them, and to use for the purpose of such operations the respective property and the cash, current assets, manufactured products and products in process of manufacture, materials and supplies now or hereafter in their respective possession hereunder, and subject to the jurisdiction and control of the Court, subject to the provisions heretofore set forth to the effect that said transfer and conveyance shall take place as of July 1, 1938.

There shall be excepted from the transfer and

conveyance to the New Company required under the foregoing provisions of this paragraph the shares representing the capital stock owned by Debtor in Shipbuilding Company, Masset Timber Company, Limited, Puget Sound Lumber and Box Company, Pacific Wirebound Box Company, Western Marine Supply Company, and Los Angeles Lumber Products Steamship Company.

There shall also be excepted from such transfer and conveyance any assets or properties owned by said Masset Timber Company, Limited, and Puget Sound Lumber and Box Company.

(11) Simultaneously with the issuance and delivery to Security-First National Bank of Los Angeles, as Distributing Agent, of the certificates representing Preferred and Common Stock of the New Company as hereinbefore provided in paragraph (8), Security-First National Bank of Los Angeles and W. N. Bucklin, Jr., as Trustees under Trust Indenture securing Debtor's bonds, shall release and deliver to Debtor all certificates representing shares of stock of Shipbuilding Company, Masset Timber Company, Limited, Puget Sound Lumber and Box Company, Pacific Wirebound Box Company, Western Marine Supply Company, and Los Angeles Lumber Products Steamship Company, and all cash (except cash necessary to pay outstanding interest coupons, together with Federal Income Tax thereon, if any, as hereinafter provided in paragraph (13) and other property of whatsoever description, including insurance poli-

cies, timber licenses and contracts, then held by such Trustees in pledge under said Trust Indenture, together with a full release, reconveyance and discharge of said Trust Indenture and any supplements thereto in such form as shall be approved by the Court.

The Debtor, upon delivery to it of the stock of the above named subsidiaries, shall and it is hereby directed as soon as practicable to liquidate the properties of the Masset Timber Company, Limited, and Puget Sound Lumber and Box Company at such prices and upon such terms as may be authorized by further order or orders of the Court, and the Debtor shall receive the proceeds of such liquidation and distribute the same in the following manner as provided by the Plan:

(a) To repay to the New Company all advances made by it to cover the cost of maintaining said properties pending their liquidation, together with interest on such advances at the rate of six per cent (6%) per annum from the date of such advance.

(b) To distribute the balance of such proceeds of liquidation to Security-First National Bank of Los Angeles, as Distributing Agent, for distribution of it ratably to the persons who have heretofore established, or who shall thereafter establish their right to receive distributions as provided in paragraph (9) of this order.

The New Company shall loan sufficient funds to pay the cost of maintaining the properties of Masset Timber Company, Limited, and Puget

Sound Lumber and Box Company until they are liquidated, the amount to be loaned to be at the discretion of the Board of Directors of the New Company and as approved by the Court.

Upon the final disposition of the properties of subsidiaries or any of them or any of them, the Debtor is hereby directed to cause such subsidiaries to be dissolved and all of the stock of such subsidiaries then held by Debtor shall be cancelled and retired.

Upon the completion of all acts required of Debtor under this order and any further orders of this Court, and upon the final consummation of the Plan, the Debtor shall take proper steps and proceedings for its dissolution and all of its outstanding stock shall be cancelled and retired..

(12) Security-First National Bank of Los Angeles, either in its capacity as Distributing Agent, as Depositary under the Plan, or as Trustee under Trust Agreement dated Aprjl 1, 1930, shall and it is hereby directed to dispose of bonds of Debtor, Trust Certificates representing such bonds, Class "A" Stock and Class "B" Stock of Debtor, and Certificates of Deposit representing such bonds, Trust Certificates, or Class "A" or Class "B" Stock now held by it in either of said capacities, or which may hereafter be surrendered to it under the provisions of this order in the following manner:

(a) All bonds and appurtenant coupons of Debtor shall be surrendered to Security-First National Bank of Los Angeles, as one of the Trustees

under the Trust Indenture securing such bonds, and such Trustee is hereby directed to cancel such bonds and coupons and to cremate the same on the final consummation of the Plan.

(b) All Trust Certificates representing bonds of Debtor shall be surrendered to Security-First National Bank of Los Angeles, as Trustee under Trust Agreement dated April 1, 1930, and such Trustee is hereby directed to cancel such Trust Certificates and to retain the same in cancelled form until the final consummation of the Plan, or until such time as the Trustee in its discretion determines the same may be cremated.

(c) All certificates representing Class "A" and Class "B" Stock of Debtor shall be surrendered to Debtor for cancellation and retirement, and Debtor is directed to cancel and retire such certificates upon the dissolution of Debtor as hereinbefore in paragraph (11) directed.

(d) All Certificates of Deposit representing bonds, Trust Certificates, Class "A" and Class "B" stock of Debtor, shall be delivered to the Depositary, and such Depositary is hereby directed to cancel such Certificates of Deposit and to retain the same in cancelled form until the final consummation of the Plan, or until such time as such depositary in its discretion determines the same may be cremated.

(e) Upon the expiration of five (5) years after the entry of this order, the Security-First National Bank of Los Angeles, as Distributing Agent, shall deliver to the New Company all of the Preferred

and Common Stock of the New Company and cash (including all dividends received on such stock) remaining in its hands undistributed under the foregoing provisions of this order, and in such case the stock and cash so delivered to the New Company shall by the New Company be distributed and paid to the persons entitled thereto under the Plan and paragraph (9) of this order and under the conditions in said paragraph prescribed. Debtor's bonds so received by the New Company shall be forthwith delivered to Security-First National Bank of Los Angeles, one of the Trustees under the Trust Indenture securing said bonds, for cancellation and cremation, pursuant to the provisions of Subdivision (a) of Paragraph (12) of this order; Trust Certificates so received by the New Company shall be delivered to Security-First National Bank of Los Angeles, Trustee under the Trust Agreement dated April 1, 1930, for cancellation and cremation, pursuant to the provisions of Subdivision (b) of paragraph (12) of this order; certificates representing Class "A" Stock of Debtor so received by the New Company shall be surrendered to Debtor for cancellation pursuant to the provision of Subdivision (c) of paragraph (12) of this order; Certificates of Deposit representing such bonds, Trust Certificates or Class "A" Stock shall be delivered to Security-First National Bank of Los Angeles, as Depositary under the Plan, and disposed of pursuant to the provisions of Subdivision (d) of paragraph (12) of this order.

(13) Security-First National Bank of Los Angeles, as one of the Trustees under the Trust Indenture securing Debtor's bonds, shall and is hereby directed to retain moneys now held by it as such Trustee for the payment of and to pay certain unsurrendered interest coupons detached from Debtor's bonds maturing prior to August 1, 1929, together with an amount sufficient to pay the Federal income tax thereon, if any.

(14) All Class "B" Stock of Debtor and Certificates of Deposit issued by the Depositary for such stock are hereby cancelled, annulled and declared to be of no value and effect.

(15) The Debtor, its subsidiary, Shipbuilding Company, and the New Company and their respective Boards of Directors are hereby authorized to pay all costs and expenses which shall be found by this Court to be reasonable in amount and approved and which shall be incident to the consummation of the Plan and the performance of this order, including all expenses of organization, taxes and fees for the issuance of the new securities, and other expenses in connection with the organization of the New Company, the application to the Commissioner of Corporations, the issuance by the New Company of the new securities in accordance with the provisions of the Plan and this order, and the services of counsel, Trustees and the Distributing Agent.

(16) The Debtor and its Board of Directors is hereby instructed and directed by this Court to

carry out the reorganization of the Debtor and of its subsidiaries in accordance with the Plan of Reorganization and this order subject to the supervision of this Court, but the Board of Directors and the members thereof shall not be subject to any personal liability in connection with carrying out the Plan, except to exercise good faith in such endeavor. The New Company shall hold harmless and defend Debtor's Board of Directors and each of the members thereof against all liability and expense arising from acts performed in good faith under the Plan or in connection therewith, provided that such expense shall be subject to review by this Court as to the amount thereof to be paid by the New Company.

(17) Upon the execution and delivery of the full release, reconveyance and discharge by Security-First National Bank of Los Angeles and W. N. Bucklin, Jr., as Trustee under the Trust Indenture, pursuant to the provisions of paragraph (11) thereof, and the payment and delivery of cash and other properties in its hands as hereinbefore provided in paragraph (11), said Security-First National Bank of Los Angeles and W. N. Bucklin, Jr. and each of them shall be exonerated, released and discharged from further responsibility of accountability as such Trustees, except for carrying out the provisions of this order and any further orders of this Court and for any liability arising out of their own misconduct or bad faith.

(18) Upon the surrender to Security-First National Bank of Los Angeles, as Trustee under Trust Agreement dated April 1, 1930, of all Trust Certificates issued and outstanding under said Trust Agreement, and the delivery by such Trustee of the bonds held by it covered by such Trust Certificates as herein provided, said Trust Agreement and all duties and responsibilities of Security-First National Bank of Los Angeles as Trustee thereunder shall cease and determine, and said Trust Agreement shall be deemed to be cancelled, abrogated and of no further force or effect.

(19) Until the transfer of all properties and assets as hereinabove in paragraph (10) provided, the Debtor and its subsidiary Shipbuilding Company may each pay, satisfy and discharge their respective indebtedness, liabilities and obligations and all such costs, expenses, allowances and disbursements in this reorganization proceeding as have been or may be approved by this Court, and may use for this purpose the property, cash, current assets, manufactured products and products in the process of manufacture, materials and supplies, which have been provided by the Plan to be transferred to the New Company.

(20) The New Company shall assume the payment and discharge of all obligations and liabilities to be assumed or paid and discharged by the New Company pursuant to the Plan and this order, including, without limiting the generalities of the foregoing, all liabilities and obligations, whether

heretofore or hereafter incurred, of the Security-First National Bank of Los Angeles, as Trustee and Depositary under the Plan of Reorganization, and as Distributing Agent under this order and all obligations of Debtor or its subsidiary, Shipbuilding Company, under executory contracts, leases and including also all expenses of reorganization and cost of administration which have been or shall hereafter be allowed by order of Court in accordance with Section 77B.

(21) That every issuance, transfer or exchange of securities (including the issuance, transfer and delivery of the New Company's Preferred and Common Stock, the transfer and surrender of Debtor's bonds and Trust Certificates representing said bonds, and the transfer and release of all of the stock of the subsidiaries of (Debtor) by this order directed or provided for in the Plan or necessary to be made to carry out the Plan and this order; and the making and delivery of the respective conveyances in paragraph (11) of this order mentioned, are all to make effective, and such securities are to be issued pursuant to, the Plan by this order and confirmed under and in accordance with the provisions of Section 77B, within the meaning of Subdivisions (f) and (h) of Section 77B of the Bankruptcy Act.

(22) All creditors and stockholders of the Debtor (including the holders of Debtor's bonds and Debtor's Class "A" and Class "B" Stock) and all creditors and stockholders of Debtor's subsidiaries

are hereby perpetually enjoined from prosecuting against the New Company or against any person or persons, corporation or corporations claiming by, under or through the New Company or against any of the properties and assets, transferred and conveyed to the New Company, pursuant to this order and any suit or proceeding arising out of or based upon any liability of or interest in the Debtor or its subsidiaries or otherwise to impose liability upon the New Company or upon any nominee or assignee or grantee of the New Company or any party to these proceedings or upon any person or persons, corporation or corporations claiming by, under or through the New Company or upon the property and assets transferred and conveyed to the New Company pursuant to this order in respect of any claim against or interest in the Debtor or in respect of any claim against or interest in its subsidiaries or to charge the New Company or any nominee, assignee or grantee of the New Company or any party to these proceedings or any person or persons, corporation or corporations, claiming by, under or through the New Company or any properties or assets transferred and conveyed to the New Company pursuant to this order with any liability on or in respect of any matter adjudicated by this order except pursuant to the provisions of and in subordination to this order. Provided, however, that nothing herein contained shall be deemed to limit or restrict the right of any claimant whose claims or any part thereof is required to be assumed

or paid by the New Company under the provisions of this order to take herein such proceedings in respect thereof as may be proper or the right of the holder of lien or charge, subject to which the assets transferred under this order or to be transferred to enforce such lien or charge.

(23) The provisions of subdivisions 1, 2, and 3 of Schedule A of Title VII of the Revenue Act of 1926, as amended by Sections 721, 722 and 723 of the Revenue Act of 1932 and the provisions of Sections 724 and 725 of the Revenue Act of 1932, shall not apply to the issuance, transfers, or exchanges of securities or the making or delivery of conveyances to make effective said Plan. Each and all of the acts required to be done hereunder in order to effect the issuance of the securities called for by the Plan are hereby determined to be for the purpose of making effective said Plan, and all issues of stock to be issued pursuant to said Plan shall be in conformity with this order for the purpose of carrying out and making said Plan effective. The surrender of all securities to be surrendered in exchange for securities to be issued as provided in the Plan is hereby found to be transfers and exchanges made to carry said Plan into effect.

(24) All securities to be issued under said Plan and pursuant to this order shall be exempt from all provisions of the Securities Act of 1933, approved May 27, 1933, as amended, except the provisions of Subdivision (2) of Section 12 and Section 17 thereof and except the provisions of Section 24 thereof, as

applied to any wilful violation of said Section 17 of said Act. All securities to be issued under said Plan and all certificates of deposit and receipts of all kinds representing securities dealt with under said Plan are hereby determined to be exempt securities within the provisions of this order and Section 77B of the Bankruptcy Act. All receipts issued by any bank, depositary, trust company, trustee or other entity designated in this order for the purpose of carrying out said Plan shall likewise be such exempt securities, and each such entity is hereby authorized to issue any and all such receipts necessary or proper to carry out said Plan of Reorganization.

(25) To the extent, if any, that the instruments, steps, or proceedings approved or authorized by this order shall involve or result in changes or modifications in the Plan, such changes, modifications, or amendments are hereby approved; and none of such changes or modifications, if any there be, in the opinion of this Court is, and the Court hereby finds and determines that none of such changes, modifications, or amendments, if any, is materially adverse to the interest of any stockholder or creditor of the Debtor or party in interest.

(26) Any injunction heretofore entered, to the extent that it restrains the use or disposition of the property of the Debtor and any of its subsidiaries, shall be of no further force or effect. Any injunction heretofore entered, however, to the extent that it enjoins and restrains stockholders and creditors

of the Debtor and any of its subsidiaries and any trustee or trustees, from commencing or continuing any suit or suits against the Debtor and any of its subsidiaries or attaching or levying upon any of their property, is hereby made final and permanent.

(27) All questions, orders, matters and things not hereby disposed of, including all matters relating to compensation for services rendered and reimbursement for actual and necessary expenses incurred in connection with these proceedings and the Plan by parties in interest or other representatives of creditors, and the attorneys or agents of any of them and including matters relating to amounts to be paid for services or expenses incident to the reorganization are hereby reserved by the Court for future determination, and this court reserves full right and jurisdiction to make from time to time such orders as it shall deem proper in exercising the powers conferred by the provisions of Section 77B, and in general reserves full right and jurisdiction to make at any time such further order or orders for the purpose of putting into effect the Plan or enforcing or carrying out this order as it deems necessary or proper, but the reservations contained in this paragraph (27) are not intended in any manner to limit or qualify the unconditional confirmation of the Plan as herein provided.

(28) The Court hereby retains jurisdiction to pass upon all tax claims now on file or which may hereafter be filed herein, and to hold hearings on

Debtor's petition for a tax bar order, and to make such order or orders as it deems necessary or proper in connection therewith.

(29) That Debtor is hereby authorized and directed to mail notice of the entry of this order in the form attached hereto as Exhibit "A" to all holders of its bonds and to all holders of certificates of deposit for said bonds and to all its Class "A" and Class "B" shareholders.

(30) Until this Court shall provide otherwise, the Debtor shall continue to have all of the title and shall exercise subject to the control of this Court all of the powers vested in such Debtor by statute and by Orders of this Court previously entered herein. The Debtor shall upon the further order of this Court file with this Court a "Debtor in Possession Bond" in such penal sum as this Court may direct, conditioned upon the faithful performance of its duties herein. The form of said bond to be first submitted to Reuben G. Hunt, Special Master, for his approval and hereafter to be subject to the approval of this Court.

(31) That the Debtor report in writing to this Court when this order has been fully complied with and all acts and things done and performed by it and the parties mentioned in said proposed Plan of Reorganization in the carrying out of said Plan.

Dated: July 19th, 1938.

Ralph E. Jenney,
Judge of said District Court of the
United States.

Approved as to form:
REUBEN G. HUNT,
Special Master.
GIBSON, DUNN & CRUTCHER,
By STUART L. LAPP,
FARIES & McDOWELL,
By J. CLIFFORD ARGUE,
WM. SCHOENAU, JR.
GEORGE R. LARWILL and
FRANK S. BALTHIS, JR.,
By FRANK S. BALTHIS, JR.,
OVERTON, LYMAN & PLUMB,
By G. L. McGAUGHEY.

[Title of District Court]
United States of America,
Southern District of California—ss.

I, R. S. Zimmerman, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing is a full, true, and correct copy of Final Order Confirming Plan of Reorganization, filed in my office on July 19th, 1938, in the matter of Los Angeles Lumber Products Company, Ltd., a corp., a debtor, No. 31,352 RJ. Bankruptcy, Central Division as the same appears from the original record remaining in my office.

Witness my hand and the seal of said Court, this 8th day of March, A. D. 1939.

(Seal) R. S. ZIMMERMAN,
Clerk.
By FRANCIS E. CROSS.
Deputy Clerk.

[Endorsed]: Filed Aug. 12, 1938. Paul P. O'Brien, Clerk.

At a Stated Term, to wit: The October Term A. D. 1937, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City and County of San Francisco, in the State of California, on Monday the Fifteenth day of August in the year of our Lord one thousand nine hundred and thirty-eight.

Present:

Honorable Francis A. Garrecht, Circuit Judge, Presiding, Honorable Clifton Mathews, Circuit Judge.

[Title of Causes.]

ORDER ALLOWING APPEAL

Upon consideration of the petition of Thomas K. Case and Adele B. Cowan, for allowance of appeal herein under Section 24(b) of the Bankruptcy Act, filed August 12, 1938, and of the assignments of error thereon, filed therewith, and by direction of the court,

It is ordered that an appeal to the United States Circuit Court of Appeals for the Ninth Circuit, from the order of the District Court of the United States for the Southern District of California, Central Division, filed and entered on the 19th day of July, 1938, be, and hereby is allowed and that the appellants need not give a cost bond upon the allowance of this appeal.

It is further ordered that pursuant to stipulation of counsel for the respective parties that the above entitled appeal may be consolidated with the appeal in Case No. 8841 in this court and that the cause may be consolidated for briefing purposes, and that no further or additional record, statement of evidence or record need be prepared, printed or filed herein, unless counsel so desire.

[Title of Circuit Court of Appeals and Cause.]

STIPULATION BETWEEN COUNSEL RESPECTING BOTH APPEALS:

It is hereby stipulated and agreed by and between all counsel for the respective parties to the above entitled proceeding that the appeal of appellants herein from the Final Order Confirming the Plan of Reorganization, filed and entered by the District Court of the United States, Honorable Ralph

E. Jenney, Judge thereof, on the 19th day of July, 1938, in Number of the United States Circuit Court of Appeals for the Ninth Circuit, may be consolidated with the record, transcript and proceedings now pending in No. 8841 of the United States Circuit Court of Appeals for the Ninth Circuit, the same being the appeal allowed from the Interlocutory Order of the District Court of the United States Confirming the Plan of Reorganization, if, in the opinion of the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit, said appeals should be consolidated.

It is further stipulated and agreed that the record, the transcript on appeal and the briefs of appellants and of Appellee in No. 8841, the appeal now pending in the United Circuit Court of Appeals for the Ninth Circuit, may all apply to, be used in and in all respects considered in both appeals herein and in this appeal, with the full intent and purpose that the record and transcript on appeal in Number 8841 together with the copy of final order herein, shall be and constitute the only record on appeal in Number , and that no further or additional transcript, statement of evidence or record need be prepared, printed or filed herein and that the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit may consider both appeals together and upon said record and transcript now on file in Number 8841 and upon the briefs filed therein and upon the hearing

thereof by said Honorable Judges of said Circuit Court of Appeals.

Dated Aug. 11, 1938.

THOMAS K. CASE,
Appellant in propria persona.
ADELE B. COWAN,
By CLARKE & BOWKER,
CLARKE & BOWKER,
Attorneys for Appellant Adele B. Cowan.
By ROBERT M. CLARKE,
FARIES & McDOWELL,
By J. CLIFFORD ARGUE,
and
GIBSON, DUNN & CRUTCHER,
By STUART L. LAPP,
Attorneys for Appellee.

[Endorsed]: Filed Aug. 15, 1938. Paul P. O'Brien, Clerk.

Nos. 8841-8951

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

THOMAS K. CASE and ADELE B. COWAN,
Appellants,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a Corporation,
Appellee.

Upon Appeals from the District Court of the United States for the Southern District of California, Central Division.

PROCEEDINGS HAD IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

PARKER PRINTING COMPANY, 543 SANSOME STREET, SAN FRANCISCO

United States Circuit Court of Appeals for the Ninth Circuit.

Excerpt from Proceedings of Thursday, December 1, 1938.

Before: Denman, Mathews and Healy, Circuit Judges.

[Title of Cause—Nos. 8841 and 8951.]

ORDER OF SUBMISSION

Ordered appeals in above consolidated causes argued by Mr. Thomas K. Case, in propriam personam, and by Mr. J. Clifford Argue, counsel for appellee, and submitted to the court for consideration and decision.

United States Circuit Court of Appeals for the Ninth Circuit.

Excerpt from Proceedings of Thursday, January 12, 1939.

Before: Denman, Mathews and Healy, Circuit Judges.

[Title of Cause—Nos. 8841 and 8951.]

ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF DECREE

By direction of the Court, ordered that the typewritten opinion this day rendered by this court in above causes be forthwith filed by the clerk of this court in accordance with the opinion rendered.

[Title of Circuit Court of Appeals and Cause.—Nos. 8841 and 8951.]

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

OPINION

Before: Denman, Mathews and Healy, Circuit Judges.

Healy, Circuit Judge.

Two appeals are here involved, one from an interlocutory order and the other from a final order confirming a plan of reorganization in a proceeding under §77B of the Bankruptcy Act. The appellants are minority bondholders.

The record contains a statement of evidence and proceedings on the hearing of the proposed plan, but concededly it is partial and incomplete. Accordingly, the appeal must be considered as one taken on the judgment role alone. In the absence of the complete record appellants have stipulated that "they intend to raise questions of substantive law only; that they will not attack the findings of the trial court on the ground that they are unsupported by evidence * *."

The debtor is a holding corporation owning all the capital stock, except directors' qualifying shares, of six subsidiary corporations. Three of the subsidiaries are without assets. Two have assets of little value, and under the plan these are to be sold and dissolution of the five subsidiaries effected.

The remaining subsidiary, Los Angeles Shipbuilding and Drydock Company, has substantial assets. This corporation builds and repairs merchant vessels and small naval craft in its yards located on sixty-eight acres of leased tide land at Los Angeles Harbor. At present its activities are confined largely to the repair of vessels, although during the world war it had carried on an extensive program of ship construction. During its busiest years it employed large numbers of men and did a gross volume of business running into the millions. After the demand for new bottoms declined its activities materially decreased.

In 1924 the debtor issued certain collateral trust bonds to mature in twenty years, the issue being secured by the hypothecation of all the capital stock of the debtor's subsidiaries, and by a trust deed lien on all their fixed assets. There are presently outstanding of this bond issue $2,565,500 face value, interest upon which has been delinquent since February 1, 1929.

Other than the lien of these bonds, the subsidiary Shipbuilding Company has only current debts of small amount which under the reorganization plan will be paid in the ordinary course of business. Its fixed assets are found to have a value of $430,000 and it has current assets, including cash, inventory and accounts receivable, not subject to the lien of the bonds, of the value of $400,000. The total value of all the assets of this subsidiary is

$830,000. The leasehold on which the plant is situated was found to have no realizable value for creditors in the event of liquidation.

The debtor has outstanding capital stock consisting of 57,065.65 shares of Class A and 5,112 shares of Class B stock of no par value. In 1930 certain of the debtor's stockholders contributed $400,000 to its capital, this new money being apparently turned over to the subsidiary Shipbuilding Company for use as working capital. Coincident therewith, the trust indenture securing the bonds was amended with the consent of those holding 97% of these obligations. The amendment effected a reduction in the interest rate of the bonds and further provided that the interest was thereafter to be paid only out of earnings. The effect of this modification of the indenture was that the lien cannot be foreclosed until the maturity of the bonds in 1944. The court found that the amendment was binding on all bondholders regardless of their consent.

In January, 1938, the debtor petitioned for reorganization under §77B and proposed a plan which the court, with some modifications, approved. The approved plan involves the organization of a new corporation to which is to be transferred all the assets of the subsidiary Shipbuilding Company, free and clear of liens. The capital stock of the new corporation will consist of 1,000,000 shares of the par value of one dollar each, divided into Class A and Class B stock, all shares having equal voting

rights. The Class A stock is preferred upon liquidation to the amount of its par value, and has preference to the extent of the payment of a 5% annual dividend, if earned. Dividends are not cumulative.

The bondholders are to receive 641,375 shares of the Class A stock, to be divided pro rata among them on the basis of 250 shares for each $1,000 bond. The balance of the Class A stock, amounting to 170,000 shares, is to be sold to furnish additional working capital. The common or Class B stock, amounting to 188,625 shares, is to be issued to the holders of the present Class A stock of the debtor corporation. The holders of the common shares are entitled to receive in any fiscal year, after a dividend of 5% for such year has been paid on the preferred shares, dividends at the rate of 5% on the par value of such common shares, when and as declared out of any funds available for the declaration of dividends. Any further dividends paid during any such year are to be distributed pro rata among the preferred and common shareholders. On liquidation or dissolution, after the holders of the preferred stock have been paid full par value, the holders of the common shares are entitled to receive the par value thereof; and any other funds or property available for distribution are to be distributed ratably among all stockholders.

A representative of the bondholders is to be named as a director of the new corporation, which will have seven directors, the remaining membership of the

board to consist of members of the debtor's present board. An election of directors for the new corporation under the reorganized setup is to be held within ninety days, under the supervision of the court, and the debtor corporation and its officers and directors are to remain neutral in such election.

This plan was accepted by the holders of 89% of the principal amount of the debtor's bonds, by the holders of 98% of its outstanding Class A stock, and by the holders of 89% of its outstanding Class B shares. No others are affected by the plan. The appellants, who hold $18,500 principal of the bonds, refused to accept the proposal.

As we understand the matter, appellants here make substantially the following contentions—(a) that as to them the plan is neither fair, equitable nor feasible and is discriminatory; (b) that the trial court erred in allowing the present stockholders of the insolvent debtor to participate in the reorganization; (c) that the plan is not fair to appellants because no provision is made for their "adequate protection" as contemplated by subdivision (b) (5) of §77B; and (d) that as minority bondholders they are not bound by the acceptance of the plan by two-thirds in amount of the class of creditors to which they belong, and cannot without their consent be deprived of their mortgage lien.

(a) The court found that—in the present state of insolvency of the debtor and its subsidiary—bonding companies are unwilling to become surety

for construction contracts, and the opportunity to bid on important construction is thus foreclosed. Also, that the Government is planning the construction of warships and auxiliary vessels and that the shipyard of the subsidiary company is equipped for the building of vessels of the proposed type. Important opportunities are thus said to be open to the debtor and its subsidiary which will be lost to stockholders and creditors alike unless reorganization can be effected. It is further found that in the present posture of affairs the bonds cannot be foreclosed until their maturity in 1944, and that even if foreclosure were now possible the bondholders would receive on liquidation substantially less than the present appraised value of the debtor's assets.

There are express findings to the effect that the plan is fair and equitable, that it does not discriminate unfairly in favor of any class of creditors or stockholders, and that it is feasible. In the state of the record and in the light of the stipulation heretofore quoted, it is not possible for this court to do other than accept these findings.

(b) In respect of the participation of the present stockholders in the proposed reorganization, the findings and stipulation again foreclose inquiry here. It was found that the value to the bondholders of maintaining the debtor as a going concern, and of avoiding litigation, is in excess of the value of the stock being issued to the present shareholders; that valuable consideration is given for such participation in the virtual abrogation of the 1930

amendment deferring foreclosure until 1944; that the continued participation of the present shareholders in the new corporation will be an asset of value to it because of the familiarity of these stockholders with the business of the subsidiary and because of their financial standing and influence in the community; and finally that the plan was offered and accepted in good faith.

We must assume there was adequate evidence to support these findings. The reorganization places the bondholders in the situation where they may exercise control. As matters now stand the present stockholders would retain control for years to come. Meanwhile stagnation in the business and deterioration of the physical plant would inevitably continue. It cannot be said as a matter of law that the extent to which the shareholders are permitted to participate is too great or that a compromise of their rights is not of substantial value to those holding the bonds. We are in no position to appraise imponderable factors seemingly of influence with the court below.

(c) Appellants complain that they are not given the "adequate protection" afforded by subdivision (b) (5) of the statute. The provisions of this subdivision are quoted on the margin.[1] Obviously they

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(1) "(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * * (5) shall provide in respect of each class of creditors of which less than

have no relevancy, since they are applicable only where less than two-thirds in amount of a given class have accepted the plan. Here more than two-thirds in amount have approved it.

(d) The statute clearly empowers the court to approve a proposal altering the rights of secured creditors "either through the issuance of new securities of any character or otherwise." A plan substituting preferred stock for secured bonds is within the purview of the act. 11 USCA §207 (b) (1), (9), (10).[2] If the proposal is found to be

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two-thirds in amount shall accept such plan (unless the claims of such class of creditors will not be affected by the plan, or the plan makes provision for the payment of their claims in cash in full), provide adequate protection for the realization by them of the value of their interests, claims, or liens, if the property affected by such interests, claims, or liens is dealt with by the plan, either as provided in the plan (a) by the transfer or sale of such property subject to such interests, claims, or liens, or by the retention of such property by the debtor subject to such interests, claims, or liens, or (b) by a sale free of such interests, claims, or liens at not less than a fair upset price and the transfer of such interests, claims or liens to the proceeds of such sale; or (c) by appraisal and payment either in cash of the value either of such interests, claims, or liens, or, at the objecting creditors' election, of the securities allotted to such interests, claims, or liens under the plan, if any shall be so allotted; or (d) by such method as will in the opinion of the judge, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection."

(2) The recent revision of the bankruptcy laws, as effected by the Chandler Act (Act of June 22, 1938),

fair and feasible and not discriminatory in favor of any class, the consent of two-thirds of a class is binding on the minority, notwithstanding their rights are materially altered[3] See In Re 333 North Michigan Avenue Bldg. Corp., 7 Cir., 84 F. (2d) 936. While their argument points in that direction, appellants disclaim any purpose of assailing the constitutionality of these provisions of the statute.

Affirmed.

[Endorsed]: Opinion. Filed Jan. 12, 1939. Paul P. O'Brien, Clerk.

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retains in clarified form the relevant provisions of the present law. Subchapter X, Chapter 10, 11 USCA §616; also subchapters VII and XI, 11 USCA §556 et seq., ibid. §621 et seq. (1938 Cumulative Supplement).

(3) So far as material, subdivision (e) of the statute, 11 USCA §207 (e) provides. "(1) A plan of reorganization shall not be confirmed until it has been accepted in writing, whether before or after the filing of the petition or answer under this section, and such acceptance shall have been filed in the proceeding by or on behalf of creditors holding two-thirds in amount of the claims of each class whose claims have been allowed and would be affected by the plan and by or on behalf of stockholders of the debtor holding a majority of the stock of each class: Provided, however, That such acceptance shall not be requisite to the confirmation of the plan by any creditor or class of creditors (a) whose claims are not affected by the plan, or (b) if the plan makes provision for the payment of their claims in cash in full, or (c) if provision is made in the plan for the protection of the interests, claims, or liens of such creditor or class of creditors in the manner provided in subdivision (b) clause (5), of this section * * *."

United States Circuit Court of Appeals
for the Ninth Circuit

No. 8841

THOMAS K. CASE and ADELE B. COWAN,
Appellants,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,
Appellee.

DECREE

Appeal from the District Court of the United States for the Southern District of California, Central Division.

This cause came on to be heard on the Transcript of the Record from the District Court of the United States for the Southern District of California, and was duly submitted:

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court, that the order of the said District Court in this cause be, and hereby is, affirmed with costs in favor of the appellee and against the appellants.

It is further ordered, adjudged, and decreed by this Court, that the appellee recover against the appellants for its costs herein expended, and have execution therefor. //

[Endorsed]: Filed and entered January 12, 1939. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit.

No. 8951

THOMAS K. CASE, ET AL.,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a Corporation.

DECREE

Appeal from the District Court of the United States for the Southern District of California, Central Division.

This cause came on to be heard on the Transcript of the Record from the District Court of the United States for the Southern District of California, Central Division, and was duly submitted:

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court, that the order of the said District Court in this cause be, and hereby is, affirmed with costs in favor of the appellee and against the appellants.

It is further ordered, adjudged, and decreed by this Court, that the appellee recover against the appellants for its costs herein expended, and have execution therefor.

[Endorsed]: Filed and entered January 12, 1939. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit.

Excerpt from Proceedings of Thursday, February 9, 1939.

Before: Denman, Mathews and Healy, Circuit Judges.

[Title of Cause—Nos. 8841 and 8951.]

ORDER DENYING PETITION FOR REHEARING, ETC.

Upon consideration thereof, and by direction of the Court, it is ordered that the petition of appellants, filed February 2, 1939, and within time allowed therefor by rule of court, for a rehearing of above causes be, and hereby is denied.

Upon consideration of the motion of appellants for retaxation of costs, filed Feb. 1, 1939, and good cause therefor appearing, ordered said motion denied.

Upon consideration of motion of appellants, filed Feb. 9, 1939, for stay of mandates of this court, and of opposition of appellee thereto, and reply of appellant to such opposition, and by direction of the court, it is ordered that said motion for stay of mandates be, and hereby is denied.

[Title of Circuit Court of Appeals and Cause—Nos. 8841 and 8951.]

CERTIFICATE OF CLERK, U. S. CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT, TO RECORD CERTIFIED UNDER RULE 38 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITED STATES.

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing three hundred eighty-three (383) pages, numbered from and including 1 to and including 383, to be a full, true, and correct copy of the entire record of the above-entitled consolidated cases in the said Circuit Court of Appeals, made pursuant to request of counsel for the appellants, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 13th day of March, A. D. 1939.

[Seal] PAUL P. O'BRIEN,
Clerk.

SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1938

No. 23

ORDER ALLOWING CERTIORARI—Filed May 22, 1939

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1938

No. 24

ORDER ALLOWING CERTIORARI—Filed May 22, 1939

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ

CHARLES ELMORE CROPLEY
CLERK

IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1938.

No. ~~[illegible]~~ 23-24

IN THE MATTER OF
LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.,
a corporation,

DEBTOR.

THOMAS K. CASE AND ADELE B. COWAN, AND ESTATE OF ADELE B. COWAN, Deceased,

Petitioners,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

THOMAS K. CASE,
1757 North Kingsley Drive, Los Angeles,
Appellant, in propria persona.

CLARKE & BOWKER,
By ROBERT M. CLARKE,
1216 Title Guarantee Bldg., Los Angeles,
Attorneys for Adele B. Cowan, Appellant and the Estate of Adele B. Cowan, Deceased.

ROBERT M. CLARKE,
THOMAS K. CASE,
Of Counsel.

Parker & Baird Company, Law Printers, Los Angeles.

SUBJECT INDEX.

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1938.

No. .....

IN THE MATTER OF

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,

DEBTOR.

THOMAS K. CASE AND ADELE B. COWAN, AND ESTATE OF ADELE B. COWAN, Deceased,

Petitioners,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

To the Honorable Charles Evans Hughes, Chief Justice of the Supreme Court of the United States, and to the Associate Justices of the Supreme Court of the United States:

Petitioners Thomas K. Case and the estate of Adele B. Cowan, deceased, pray that a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit, may issue to review the decree of that Court made upon the 12th day of January, 1939, in the above mentioned cause. Adele B. Cowan, then an appellant, died after that decree was made.

Statement of Proceedings in Court Below.

This cause arose under the provisions of Section 77B of the Bankruptcy Act (approved June 7th, 1934, 48 Stat. 912; 11 U. S. C. A., section 207, and hereinafter for convenience referred to as "Section 77B.") by the filing on January 28th, 1938, in the District Court of the United States for the Southern District of California, Central Division, of a petition by Los Angeles Lumber Products Company, Ltd., a California Corporation, Debtor, for leave to reorganize. From two decrees of that District Court confirming the Debtor Corporation's Amended Plan of Reorganization, the appellants appealed to the United States Circuit Court of Appeals for the Ninth Circuit. These appeals were consolidated by order of the Circuit Court. [R. 366.] The United States Circuit Court of Appeals for the Ninth Circuit, in a decision rendered January 12th, 1939, affirmed the decrees of the Court below approving the Amended Plan of Reorganization. [R. 372.]

Appellants on February 2nd, 1939, filed their petition for rehearing in the United States Circuit Court of Appeals for the Ninth Circuit. On February 9th, 1939, the latter Court denied appellants' petition for rehearing, and on the same date denied the petition of appellants for a Stay of Mandate. [R. 383.]

The Parties.

The parties in interest in this matter are the following: Los Angeles Lumber Products Company, Ltd., a California Corporation, hereinafter for convenience referred to as "the Debtor Corporation," was the petitioner in the District Court of the United States for the Southern District of California, for leave to reorganize under the provisions of section 77B of the Bankruptcy Act, and is the appellee in the Circuit Court.

The above named petitioners, Thomas K. Case and Adele B. Cowan, were the appellants in the United States Circuit Court of Appeals for the Ninth Circuit. They are dissenting bondholders owning $18,500 in face value of a first mortgage lien represented by a trust deed for the sum of $3,500,000 executed by Debtor Corporation and by its wholly owned subsidiary, the Los Angeles Shipbuilding and Dry Dock Corporation.

These two dissenting bondholders have not deposited their bonds and have never consented to any of the proceedings by Debtor Corporation, and as such bondholders were allowed to intervene in the reorganization proceedings in the District Court.

Recently appellant, Adele B. Cowan, passed away and the legal representatives of her estate have been substituted herein.

Summary Statement of the Matter Involved.

For several years prior to February 1st, 1929, the Debtor Corporation was engaged in the lumber business and later, through its subsidiary then in the shipbuilding business, constructed commercial vessels. They are not equipped to build warships and if a shipbuilding construc-

tion program is undertaken, it will require about $500,000 for necessary repairs. [R. 71.]

On February 1st, 1924, Debtor Corporation and Los Angeles Shipbuilding and Dry Dock Corporation by trust deed jointly executed by them, secured an authorized bond issue of $3,500,000. Los Angeles Lumber Products Company First Lien and Collateral Trust Twenty Year Seven and One-half Per Cent Sinking Fund Gold Bonds. Debtor corporation claims that there are outstanding of this bond issue, $2,565,500 face value, upon which no interest has been paid since February 1st, 1929. [R. 326.] These bonds are payable to bearer and by their terms would become due February 1st, 1944. To the amended plan of reorganization approved by the District Court, owners and holders of 92.81 per cent face value of Debtor Corporation's outstanding bonds, have consented to the plan. [R. 210.]

The case before the Circuit Court comprehends two appeals which were ordered consolidated by that court. [R. 366.] The first is the appeal from the "Interlocutory order" confirming the amended plan of reorganization and the second appeal is from the final order confirming the plan.

Debtor filed on January 28th, 1938, its petition in the District Court of the United States for the Southern District of California, Central Division, for leave to reorganize under the provisions of section 77B of the Bankruptcy Act and on that date that Court made its order finding that the petition had been filed in good faith.

The Shipbuilding & Dry Dock Corporation is a wholly owned subsidiary of the Los Angeles Lumber Products Company. [R. 66.]

The assets of Debtor Corporation are appraised herein at the sum of $830,203.23. [R. 80.]

This does not include the Los Angeles Harbor Leasehold interest which has been appraised at $1.00 and is carried on the books of the Debtor Corporation at no value. [R. 69.] This lease of valuable harbor frontage runs until 1952 and for it an annual rental is paid of $21,500. [R. 70.]

As shown by Debtor Corporation's petition for leave to reorganize, "the holders of debtor's bonds and debtor's stock are the only creditors and persons whose claims and interests will be affected by the plan" [R. 13, 16] and "all of the other creditors of debtor shall be paid the amount of their claims in full in cash and are thus not affected by the plan." [R. 13.]

The Los Angeles Lumber Products Company effected a reorganization in 1930 by which it became a limited liability corporation under state law and is the appellee in the proceedings before the Circuit Court.

Appellants in the Circuit Court of Appeals and petitioners herein for writ of certiorari are the only dissenting bondholders here, who have never deposited their bonds and have never consented to any of the past proceedings, either in 1930 or since then and have actively opposed the proceedings to reorganize under section 77B. [R. 108.]

Appellant Case has $13,500 face value bonds, and appellant Cowan, recently deceased, now represented by her estate, had $5,000 face value bonds, all of this first mortgage issue and all with interest coupons attached. Based upon these ownerships, the claims of petitioners herein were duly filed by them and were allowed and approved by the District Court. [R. 45, 151, 333.]

The Special Master's report was approved by the District Court, as shown by the Transcript of Record, with some minor exceptions which do not concern any of the bondholders. [R. 313.]

The amended plan of reorganization, which has been confirmed by the District Court and by the United States Circuit Court of Appeals for the Ninth Circuit, awards to bondholders 250 shares of the newly created preferred capital stock (par value of each share being $1.00) for each $1,000 bond, "the principal amount of the bonds" only. The plan also awards 188,625 shares of new common stock to Debtor's Class A shareholders who constitute the present stockholders of Debtor Corporation. [R. 58, 59, 342.]

Debtor is an insolvent corporation "both in the bankruptcy sense and in the equity sense." [R. 319.]

Although admittedly insolvent, twenty-three per cent of the new capital stock is awarded to the old stockholders. [R. 88, 92, 93.]

No allowance is made for the due and unpaid interest on the bonds, unpaid since February 1st, 1929 [R. 326], and which represents a sum now equal to the principal amount due on the bonds.

These bonds are to be "cremated" [R. 352, 353] and Debtor Corporation and its stockholders and unsecured creditors would receive, freed from the mortgage lien, all assets pledged in the trust deed. [R. 32, 331, 342, 343.]

The plan as approved is made "binding" upon appellants and petitioners herein, as secured creditors under the bond issue. [R. 151.]

Appellants contend that Debtor is estopped in this proceeding under the provision of that trust deed compre-

hending section 5, article 2, on page 29 of that instrument, as the same is set forth in *haec verba* in the Transcript of Record, pages 55, 56, 259.

Debtor contends that, notwithstanding the fact that petitioners herein, have never consented to any procedure, that they are bound by the consent to the plan, of bondholders owning more than 75 per cent of the outstanding bonds. [R. 261.]

All that petitioners herein, as dissenting bondholders, would receive for their bonds under the approved plan, would be shares of new capital stock representing a dollar for dollar face value of *one-eighth of the total amount due to them, as unpaid principal and interest* due and unpaid.

The transcript, consented to by all parties and printed and used in the Circuit Court, shows all of the foregoing facts.

The appeal to the United States Circuit Court of Appeals for the Ninth Circuit was based upon the transcript which contained the orders of the District Court and all necessary evidence as agreed upon and admitted for the purposes of that transcript, and upon the briefs. That transcript is complete for all purposes of the appeal which is based upon the questions of substantive law shown by the record to be involved herein. Appellants' stipulation not to attack the findings of facts of the trial court on the ground that they are unsupported by evidence, does not prevent them from raising the questions of law and standing upon the substantive law involved and as revealed by the District Court's confirmation of an unfair plan. This is a plan which destroys the substantive right to their first mortgage lien which exists in petitioners and where an

insolvent corporation secures 23 per cent of its new capital stock for present stockholders who have no equity therein.

The transcript is complete for the purposes of the appeal and it contains all necessary features to present the questions of substantive law which are involved herein. The stipulation not to attack the findings of facts of the trial court upon the evidence, itself contains the six grounds upon which the appeal is based. [R. 286, 287.] The sixth point therein "that appellants contend that as to them, said plan is neither fair, equitable nor feasible and is discriminatory", is supported not alone by the transcript but by the judgment roll alone. The six points set forth in that stipulation, involve questions of substantive law. [R. 286.] If, in the opinion of debtor corporation, there was not deemed sufficient evidence presented by the transcript, it had the undoubted right to require that more evidence be printed in the transcript. This it did not do. The partial statement of the evidence was the one settled by the District Court without objection from, and was done with the consent of, counsel for Debtor Corporation. That Court's order was made July 6th, 1938, as shown by the transcript of record. [R. 263.]

Petitioners do not consider that this appeal to the Circuit Court of Appeals depends upon the judgment roll alone. The "Stipulation Between Counsel Respecting Both Appeals", which was signed on August 11th, 1938, by all attorneys for Debtor Corporation and all attorneys for appellants, contains the following recitation, to-wit:

> "It is further stipulated and agreed that the record, *the transcript on appeal* and the briefs of appellants and of appellee in No. 8841, the appeal now pending in the United States Circuit Court of Appeals for the Ninth Circuit, may all apply to, be used in and

in all respects considered in both appeals herein and in this appeal, with the full intent and purpose that the record and *transcript on appeal* in No. 8841, together with the copy of final order herein, shall be and constitute the *only* record on appeal in number ....., *and that no further or additional transcript, statement of evidence* or record need be prepared, printed or filed herein and that the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit may consider both appeals together and upon said record *and transcript* now on file in number 8841 and upon the briefs filed therein and upon the hearing thereof by said Honorable Judges of said Circuit Court of Appeals." [R. 367.] (Italics ours.)

This stipulation was made by all counsel with the intent to persuade the United States Circuit Court of Appeals to consolidate these two appeals and it consents to that particular record described therein and which then existed before the United States Circuit Court of Appeals for the Ninth Circuit in the pending first appeal known as number 8841.

The order of the United States Circuit Court of Appeals, based upon the foregoing stipulation, and made by that Court upon the 15th day of August, 1938, in case No. 8951, concludes as follows, to-wit:

"It Is Further Ordered that pursuant to stipulalation of counsel for the respective parties that the above entitled appeal may be consolidated with the appeal in Case No. 8841 in this Court and that the cause may be consolidated for briefing purposes, and that no further or additional record, statement of evidence or record need be prepared, printed or filed herein, unless counsel so desire." [R. 366.]

These show clearly that the transcript and the record, then completed in No. 8841, was acceptable to all counsel for all parties and as such, was then accepted by the United States Circuit Court of Appeals for the Ninth Circuit.

In the transcript appears some of the evidence of Debtor Corporation as well as some evidence of appellants and with this both sides of the litigation were satisfied. The record clearly shows the questions of substantive law involved. All questions of law presented by the record on appeal are shown in the judgment roll, the transcript and in all briefs which treated the record as complete. In no sense is the transcript incomplete for the purpose of presenting the questions of law involved in the appeal.

If this judgment is allowed to stand, all insolvent corporations in the country, burdened by bond issues, can and many will use it as a precedent under 77B, to cancel their bonds, appropriate to themselves all assets pledged in their bonded debts, will ignore all interest due and unpaid on their bonds and will award to their present stockholders who have no equity therein, substantial portions of the new capital stock without any other consideration therefor and thus retain control over and disposition of the assets of the new corporation. That consummation would then obtain where present stockholders, as in this case, do not agree to advance any new money, even where in cases, as in this case at bar, new money is shown to be absolutely necessary. All of this could be achieved without the payment of any valuable consideration and upon a mere offer of shares of capital stock in a new corporation which would have little or no value. This could be done a second time with new bond issues secured by the *same*

assets. Such a corporation, having obtained cancellation of its bonds, could sell the released assets, having no new money with which to do business and abandon the corporation. Truly, indeed, would then result the huge loss to bondholders who had been forced to become only stockholders; bondholders who, like appellants, paid full face value and accrued interest for their bonds. In this case the transcript shows that *present stockholders* now owning nearly a million dollars in face value bonds, acquired them at 6½ cents on the dollar. [R. 254.]

In no way does the transcript or do the briefs attack the *findings of fact* made by the trial Court. Appellants believe that the *conclusions of law* of the trial Court, based upon those findings of fact, are erroneous, do not represent the law of the land and can find no justification under any of the provisions of Section 77B of the Bankruptcy Act. If that decision stands and the affirmation of the Circuit Court of Appeals for the Ninth Circuit is the law in reorganization proceedings under 77B, then a bond is not a bond, or a secured lien, or a mortgage. It represents only future shares of capital stock in a new corporation whose stock would have little or no value.

To thus relegate dissenting bondholders who bought a first mortgage lien, to the grossly inferior position of stockholders is abhorrent to the spirit of justice, to the principles of law long established and was never contemplated by the provisions of Section 77B.

The importance of this case greatly transcends any possible fate of these petitioners. It affects materially the many thousands of purchasers of bonds in existing and future private corporations.

Questions Involved and Reasons for Allowance of the Writ of Certiorari.

Under the decision of the District Court and affirmed by the Circuit Court, substantive property rights have been taken from dissenting bondholders without adequate compensation. The first mortgage lien of petitioners constitutes such a right. The Supreme Court of the United States has decided that

> "the right to retain the lien until the debt secured thereby is paid, is a substantive property right which may not be taken from the creditor consistently with the 5th and 14th Amendments to the Constitution."
>
> *Louisville Joint Stock Co. v. Radford,* 295 U. S. 555.

That involves the first point urged in this petition. Several decisions of the United States Circuit Courts of Appeals have quoted and adopted this doctrine.

In this case this private corporation's bond is a first mortgage lien. That bond is a bond and not to be destroyed by exchanging therefor a small number of shares of $1.00 par value each of new capital stock. This new corporation is dependent for its existence upon the acquisition by it, freed from the lien, of the assets which are pledged in the trust deed securing these bonds.

There is nothing in 77B of the Bankruptcy Act, or elsewhere, which authorizes a first mortgage lien to be cancelled and permits an insolvent corporation to appropriate all of the assets pledged in and securing that lien,

in sole consideration of the issuance of a small number of shares of capital stock in a new corporation and which is much smaller than the old corporation.

No plan of reorganization similar to this plan, or in any way half as unfair in its pretended attempt to compensate for bonds taken, exists so far as can be found. Not even in railroad or in public utility reorganizations, in all of which the public interest was involved, has there been confirmed a plan of reorganization which would cancel the bonds of a private corporation, appropriate all assets securing the bonds and for these, award only shares of capital stock in a new corporation which would thus be enabled to do business with those assets thus acquired.

The plan in this case also denies any compensation for all due and unpaid interest on the bonds—now equal in amount to the unpaid principal due on the bonds. There are several decisions of the United States Circuit Courts of Appeals which have decided that this cannot be done.

Under another point involved in this appeal, several decisions of United States Circuit Courts of Appeals have uniformly held that present stockholders of insolvent corporations have no equity therein and are not entitled to shares of new capital stock in reorganized corporations. When such a consummation is sought it is always for the purpose of perpetuating control of the new corporation in the hands of the old stockholders who have declined to meet the obligation of their bonded debts.

In practically all of the cases of corporations seeking permission to reorganize, there have been vast majorities of the bondholders who have "consented" to the plans. This has been due to the machinations of "Bondholders' Protective Committees" and those in privity with them, especially large stockholders. Their practices in securing the consents of bondholders, have attained the scope of a national scandal.

Debtor Corporation claims that petitioners herein are bound by the consent of the majority. There is nothing in 77B or in the general law which permits that consummation. On the contrary, there are cases decided by the Supreme Court and by several United States Circuit Courts of Appeals which hold the opposite view. These cases determine that dissenting bondholders, as a minority, are not bound by any majority, however large, and cannot be deprived of their legal rights by any contract to which they are not actually a party.

Under the circumstances disclosed by the transcript of record before this Court, there was not compensation provided for dissenting bondholders and the plan does not afford them the "adequate protection" required by Section 77B, subdivision (b)(5) of the Bankruptcy Act. The question of adequate protection within the meaning of the Act, does not seem, so far as we can find, to have directly reached the Supreme Court. Perhaps we are dependent for construction of that provision of the Act upon the several decisions of the United States Circuit Courts of Appeals. None of the Federal Courts seem to have had

before them any plan of tendering only shares of capital stock for the bonds, like the plan in this case. Always there was either: cash for the bonds, or half-cash for the old bonds and the remainder in new bonds, or mainly cash for the old bonds and shares of capital stock for a small unpaid balance—and then only when present stockholders tendered "new money" to enable the new corporation to do business. No new money is tendered in this plan and new money is found to be necessary in the orders of the District Court, a part of the judgment roll set forth in the transcript of record. The decisions quoted and cited in our brief to this petition show that there has not been proposed any plan like this one in the case at bar. The District Court had not the legal right to substitute its hope for the future success of a reorganized corporation, for any plan manifestly unfair. That the District Court thought, and the Circuit Court probably believed by affirming, that by permitting the reorganization in this case that bondholders might eventually be better off with only shares of new capital stock, by allowing the experienced and wealthy stockholders to continue the building of commercial ships, is opposed to the law governing this case. That view of the trial Court is designed to build up an equity in the old stockholders where they are not entitled to an equity and permits a gamble upon the corporation's being able to do business successfully in the future where it has failed in the past.

Petitioners believe that the transcript of record before this Court establishes the fact that this plan of reorgani-

zation, as to dissenting bondholders, is neither fair, equitable nor feasible (without the necessary new money) and is discriminatory in that it awards all of the mortgaged assets to present stockholders of Debtor Corporation, additional stockholders and to its general and unsecured creditors.

Petitioners urge that the lower Court should have decided the question of estoppel of debtor under a provision of debtor's own contract—the trust deed. This was specially pleaded in the trial Court and is based upon section 5, of article 2, on page 29 of the trust deed. This appears fully and in *haec verba* in the transcript of record before the Court, that being the exact transcript required by the amended praecipe which was consented to by all counsel in the case. [R. 288.]

That such plan of reorganization as was adopted in this case is unfair and inequitable, is shown by numerous decisions of the United States Circuit Courts of Appeals, from which appeals were not taken to the Supreme Court of the United States.

Presented herewith are questions of law which involve substantive rights and are furnished by the record in this case. The points of law presented in the briefs on appeal, by the judgment roll and the transcript, are those repeated in the brief accompanying this petition, with the citation of such authorities as we have been able to find and some of which are of very late dates.

Wherefore, your petitioners respectfully pray that a Writ of Certiorari be issued under the seal of this Court directed to the United States Circuit Court of Appeals for the Ninth Circuit, to the end that this cause may be reviewed and determined by this Court and that the judgment of the Circuit Court of Appeals and of the District Court of the United States for the Southern District of California may be reversed, and that your petitioners, Thomas K. Case and the estate of Adele B. Cowan, deceased, may have such other and further relief as this Court may deem proper in the premises.

Dated Los Angeles, California,

March 23rd, 1939.

Respectfully submitted,

THOMAS K. CASE,

Petitioner and Appellant in Propria Persona,

CLARKE & BOWKER,

By ROBERT M. CLARKE,

Attorneys for Adele B. Cowan, Appellant and Petitioner, and the Estate of Adele B. Cowan, Deceased.

STATE OF CALIFORNIA,
COUNTY OF LOS ANGELES. } ss.

Robert M. Clarke, being first duly sworn, deposes and says: that he is a member of the bar of the Supreme Court of the United States and is an attorney for the estate of Adele B. Cowan, deceased, who was known herein as Adele B. Cowan who was an appellant in the proceedings before the United States Circuit Court of Appeals for the Ninth Circuit in the above-entitled matter; that he makes this verification on behalf of Thomas K. Case and Adele B. Cowan, appellants, and the Estate of Adele B. Cowan, Deceased, as petitioners herein; that affiant has read the foregoing petition, was the attorney for said appellant Adele B. Cowan, and has knowledge of this litigation; that the matters stated in said petition are true to the best of his knowledge, information and belief; that the foregoing petition is well founded and entitled to the favorable consideration of this Court and that it is not interposed for the purpose of delay.

ROBERT M. CLARKE.

Subscribed and sworn to before me this 23rd day of March, 1939.

[Seal] C. STEPHENS

Notary Public in and for the County of Los Angeles, State of California.

My commission expires Jan. 26, 1942.

IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1938.

No. .....

IN THE MATTER OF

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,

DEBTOR.

THOMAS K. CASE AND ADELE B. COWAN, AND ESTATE OF ADELE B. COWAN, Deceased,

Petitioners,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinions of the Courts Below.

The decision, judgment and decree of the District Court of the United States, for the Southern District of California, Central Division, in proceedings for reorganization,

No. 31,352 RJ. and confirming Debtor Corporation's plan of reorganization, is reported in 24 Fed. Suppl. 501.

The opinion of the United States Circuit Court of Appeals for the Ninth Circuit [R. pp. 372-380] is reported in 100 Fed. (2d) 963.

The United States Circuit Court of Appeals did not render an opinion upon denial of the Petition for Rehearing filed in this cause.

The Final Order Confirming Plan of Reorganization, made by the District Court, appears in the Transcript of Record furnished to this Court, on pages 306-364;

The Interlocutory Order Confirming Plan of Reorganization, made by the District Court, appears in the Transcript of Record furnished to this Court, on pages 129-155.

II.

Jurisdiction.

The Supreme Court is asked to exercise its jurisdiction under Section 240(a) of the Judicial Code (28 U. S. C. A., 347; 43 Stat. 938). *Stoll v. Gottlieb,* decided Nov. 21st, 1938 Advance Opinions 1938-1939, Vol. 83, p. 116, 59 Sup. Ct. 134, and under *In re 620 Church St. Bldg. Corporation,* 299 U. S. 24, 27; 57 Sup. Ct. 88, 89, 81 L. Ed. 16.

Judgment of the Circuit Court of Appeals affirming the judgment of the District Court, was entered January 12th, 1939, [R. 372, 380] and the opinion of the Circuit Court of Appeals, by minute order, denying the Petition for Rehearing filed by your petitioners, was made February 9th, 1939. [R. 383.]

III.

Statement of the Case.

A summary statement of the matter involved in this case is made in the Petition for Writ of Certiorari and for that reason is not repeated here.

IV.

Specification of Errors.

1. The Circuit Court of Appeals for the Ninth Circuit erred in concluding under the circumstances disclosed in this case, that petitioners, as dissenting bondholders, should be deprived of and lose their first mortgage lien, their right to foreclose and other substantive rights; [R. 274, 302.]

2. That the Court erred in concluding under the circumstances disclosed in this case, that present stockholders of an insolvent corporation in which they have no equity, could participate in the plan of reorganization, either to the extent of 23 per cent or any other percentage; [R. 275, 303.]

3. That the Court erred under the circumstances disclosed in this case, in sustaining a plan that is not fair because no compensation is provided for dissenting bondholders for the loss of their mortgage lien, and a plan which does not afford them the "adequate protection" required by section 77B, subdivision (b) (5) of the Bankruptcy Act; [R. 275, 303.]

4. That the Court erred in depriving of their substantive rights, these petitioners as dissenting bondholders, as a minority who are not bound by any majority of consenting bondholders, however large, and that appel-

lants cannot be deprived of their rights as "non-assenting creditors" by any kind of a contract to which they are not actually a party, even though more than 75 per cent have consented to the proposed plan; [R. 276, 303, 304.]

5. That the Court erred in depriving petitioners of the interest promised in the bonds, also represented by coupons attached to the bonds and an integral part of those bonds and for which no compensation or consideration of any kind has been allowed or extended to dissenting bondholders; [R. 277, 304.]

6. That the Circuit Court erred in sustaining a plan which as to dissenting bondholders is neither fair, equitable nor feasible (in that no necessary new money is offered) and is discriminatory in that it discriminates unfairly in favor of unsecured creditors and present and future stockholders of Debtor Corporation and against the rights of petitioners as dissenting bondholders; [R. 278, 304.]

7. That the Court erred in not deciding the doctrine of estoppel of debtor corporation which was specially pleaded and in which connection petitioners rely upon section 5 of article 2, page 29 of the trust indenture and which appears fully and in *haec verba*, in the transcript before the Court, which transcript was required by the amended praecipe and which transcript and praecipe were consented to by all counsel in this case; [R. 268, 55, 56, 259.]

8. That the Circuit Court erred in deciding that the judgment and decree of the District Court of the United States confirming debtor corporation's plan of reorganization, should be affirmed.

AUTHORITIES AND ARGUMENT.

I.

The Court Erred in Concluding Under the Circumstances Disclosed in This Case, That Petitioners, as Dissenting Bondholders, Should Be Deprived of and Lose Their First Mortgage Lien, Their Right to Foreclose and Other Substantive Rights.

This Plan Takes Away From Petitioners Their Vested Rights in the Properties Mortgaged by Debtor to Secure Payment of the Bonds, Without Payment in Full, Without Payment of Any Due and Unpaid Interest on the Bonds and, Only for "the Principal Amount of the Bonds", Offers Preferred Stock in a New Corporation on an Unfair and Inadequate Basis. Debtor Would Retain, Freed From the Mortgage Lien, All of the Pledged Assets for the Benefit of Debtor's Unsecured Creditors and Its Stockholders.

> "All bonds and appurtenant coupons of debtor shall be surrendered to Security-First National Bank of Los Angeles, as one of the trustees under the trust indenture securing such bonds and such trustee is hereby directed to cancel such bonds and coupons and to cremate the same on the final consummation of the plan." [R. (a) 352, 353.]

The Supreme Court of the United States in *Louisville Joint Stock Co. v. Radford*, 295 U. S. 555, said:

> "The right to retain the lien until the debt secured thereby is paid, is a substantive property right which may not be taken from the creditor consistently with the 5th and 14th Amendments to the Constitution."

There the Supreme Court, on pages 589 *et seq.*, added:

> "Fourth. The Bankruptcy power, like the other great substantive powers of Congress, is subject to the 5th Amendment."

That Supreme Court case was cited and this doctrine followed by the United States Circuit Court of Appeals for the Ninth Circuit, in *Security-First Nat'l Bank v. Rindge Land Co.*, 85 Fed. (2d) 557, where, on page 561, in subdivision 3 of that decision, the Court said:

> "There is nothing in Section 77B which authorizes a debtor to pay a secured creditor less than half of the amount of the debt, while retaining to his own use a portion of the property securing the debt."

and also on that same page:

> "The right to retain a lien until the debt secured thereby is paid, is a substantive property right which may not be taken from the creditor consistently with the 5th and 14th Amendments to the Constitution. (Louisville Joint Stock Co. v. Radford, 295 U. S. 555.)"

and also in subdivision 5 of that Ninth Circuit Court decision, appears the following:

> "Section 77B, subd. (A), 11 U. S. C. A., section 207, gives the Court equity powers but it does not purport to alter long established incidents of property by introducing a vague and indefinable 'equity' into the proceedings. (*In re* Judith Gap Co. v. Commercial Co., C. C. A. 8, 5 Fed. (2) 307. (Certiorari denied by U. S. Supreme Court Jan. 4th, 1937.))"

The record in this case shows that all that is offered to dissenting bondholders are shares of the capital stock of the new corporation to be organized, "for

the principal amount of the bonds" and nothing is allowed for the unpaid interest on the bonds and which alone, is now equal to the principal amount now due on the bonds.

No case is cited by appellee, and we believe none exists, where nothing but capital stock of a new or reorganized company is offered to dissenting bondholders.

In the late case deciding this question, of *In re Day and Meyer, Murray and Young,* 93 Fed. (2d) 657, rendered January 3rd, 1938, by the Second Circuit Court of Appeals (N. Y.), it was determined:

> "A reorganization plan providing that first mortgage bonds be reduced to one-half of their principal amount and that the equity thereby created be represented by issuance of new preferred and common stock, to be shared by bondholders with general creditors, present preferred stockholders and management, and eliminating the total amount of interest past due on the bonds, was unfair and should not have been confirmed * * * since the plan did not preserve priorities and deprived bondholders of their lien.
>
> *"Such a plan does not preserve priorities. See Northern Pacific Co. v. Boyd,* 228 U. S. 482."

The opinion of the Ninth Circuit Court of Appeals ignores this important question of substantive law which has been repeatedly affirmed by it and opposes its prior decisions as herein quoted.

Among other cases holding that a plan of reorganization which takes from the bondholders the mortgaged property of the debtor corporation and appropriates it unconditionally to the debtor and its unsecured creditors without

payment to dissenting bondholders and violates the 5th and 14th Amendments to the U. S. Constitution, are:

Continental Ills. Nat'l Bank v. Chicago Rock Isl., 294 U. S. 648;

Northern Pacific Co. v. Boyd, 228 U. S. 482, that priorities are not preserved;

In re Tennessee Publishing Co., 299 U. S. 18, in which a statute of Tennessee was construed.

The California statute, section 726, Code of Civil Procedure, is much stronger than the statutes of either Tennessee or Kentucky. In 6A *California Jurisprudence*, section 800, on page 1371, it is asserted:

> "Upon a reorganization, the bondholders have the right, without regard to any of the equities of the stockholders or creditors of the Company, to foreclose their lien and bid in the properties."

Note 14 cites *Ginty v. Ocean Shore Railroad Co.*, 172 Cal. 31.

Section 800 of 6A *Cal. Jur.* is headed "Reorganizations by Bondholders—such as Railroads." Undoubtedly in considering reorganizations by "railroads" and public utility corporations, the courts might look more favorably upon them, solely because of the "public interest" in them. That is expressly enunciated in the proposed reorganizations of railroads and public utilities.

Section 726, *C. C. P.*, commences:

> "There can be but one form of action for the recovery of any debt or the enforcement of any right secured by mortgage upon real or personal property, which action must be in accordance with the provisions of this chapter.", etc. Then it provides for the sale of such property.

II.

The Court Erred in Concluding Under the Circumstances Disclosed in This Case, That Present Stockholders of an Insolvent Corporation, in Which They Have No Equity, Could Participate in the Plan of Reorganization, Either to the Extent of 23 Per Cent or Any Other Percentage.

We fail to find where the opinion of the Court of Appeals decides this question. It has been frequently held that where a corporation is insolvent there is no equity for present stockholders. The findings of the trial court show that this corporation is insolvent and that they may participate to the extent of 23 per cent of the capital stock of the new corporation. [R. 88, 90.]

The Supreme Court in *In re 620 Church Street Building Corporation*, 299 U. S. 24, 27, 57 S. Ct. 88, 89, 81 L. Ed. 16, was of the opinion that

> Unless the property of the debtor exceeded in value the amount of the claims of creditors, the stockholders had no interest to protect or preserve.

The following cases all hold that where a corporation is insolvent, there is no equity to entitle the present stockholders to participate in the stock of the new company:

In re Day and Meyer, Murray & Young (2d Cir.), 93 Fed. (2d) 657;

In re Barclay Park Corporation (2d Cir.), 90 Fed. (2d) 595;

Reading Hotel Corp. v. Prot. Com., 89 Fed. (2d) on page 53;

O'Connor v. Mills (8th Cir.), 90 Fed. (2d) 665, 667;

Brunkenfeld v. N. Y. Railways, 82 Fed. (2d) 740 and 744;

Wayne Un. Glass v. Owens Ills. Glass Co., 91 Fed. (2d) on page 832;

Price v. Spokane Silver & Lead Co., 97 Fed. (2d) 237.

In a very recent case, *In re Vicksburg Bridge Co.*, 22 Fed. Supp. 490, in the issue of April 18th, 1938, on page 507, the concluding words of that decision are:

> "The conclusion is inescapable, therefore, that the debtor is insolvent and there would be no equity for stockholders which would entitle them to participate in the reorganization."

This is the second case in 1938 which so holds—the other being *In re Day and Meyer, supra.*

The third case decided in the year 1938, the very recent one, decided August 24th, 1938, 8th Circuit, that of *Sophian, et al. v. Congress Realty Co.*, 98 Fed. (2d) 499, that Court held:

> "(2) Section 77B cannot be used to aid stockholders at the expense of bondholders or other creditors, or for the purpose of continuing in business a corporation hopelessly insolvent and unable to prosecute its business with any reasonable prospect of success. Brockett v. Winkle Terra Cotta Co., 8 Cir., 81 Fed. (2) 949, 953; First Nat'l Bank v. Conway Road Estates Co., 8 Cir., 94 Fed. (2) 736, 839; Price v. Spokane Silver & Lead Co., 8 Cir., 97 Fed. (2) 237, 245, 246; and also
>
> "(3) Stockholders may not better their position at the cost of bondholders or other creditors; and to justify a retention of stock interest by stockholders

of a debtor it must appear that they have furnished some compensatory additional consideration or have an equity in the estate of the debtor after the rights of creditors are fully provided for. See *In re* Barclay Park Corpn., 2 Cir., 90 Fed. (2) 595, 597, 598; *In re* Day and Meyer, Murray and Young, Inc., 2 Cir., 93 Fed. (2) 657; O'Connor v. Mills, 8 Cir., 90 Fed. (2) 665, 666, 667; Reading Hotel Corp. v. Protective Committee, 3 Cir., 89 Fed. (2) 53; Wayne United Glass Co. v. Owens-Illinois Glass Co., 4 Cir., 91 Fed. (2) 827, 832; Price v. Spokane Silver & Lead Co., *supra,* at page 245; and also

"(4) It is the duty of the Court of Bankruptcy to carefully scrutinize plans of reorganization proposed for insolvent companies to make certain that the assets belonging to creditors are not, by indirection, diverted to stockholders. *In re* N. Y. Railways Corp., 2 Cir., 82 Fed. (2) 739, 744; *In re* Day and Meyer, Murray & Young, Inc., *supra,* at page 659; Price v. Spokane Silver & Lead Co., *supra,* at page 245."

The fourth case decided in the year 1938, on June 13th of that year, 8th Circuit, that of *Price v. Spokane Silver & Lead Co.,* 97 Fed. (2d) 237, on page 245, it is said:

"(8-10) The Court also erred in confirming the plan of reorganization, which made no distinction between creditors and stockholders, and placed them on a substantial parity. Unless the property of the debtor exceeded in value the amount of the claims of creditors, the stockholders had no interest to protect and preserve. *In re* 620 Church Street Building Corporation, 299 U. S. 24, 27, 57 S. Ct. 88, 89, 80 L. Ed. 16. We find nothing in the evidence, except generalizations and prophesies, to warrant any conclusion that the value of the assets of the debtor even

equalled its liabilities, excluding its stock liability. To justify a retention of a stock interest by present stockholders of the debtor, it should appear that they have furnished an additional consideration, or have an equity in the estate of the debtor after the rights of creditors are fully provided for. *In re* Barclay Park Corporation, 2 Cir., 90 Fed. (2) 595. See, also, *In re* Day & Meyer, Murray & Young, Inc., 2 Cir., 93 Fed. (2) 657; O'Connor v. Mills, 8 Cir., 90 Fed. (2) 665, 667; Reading Hotel Corporation v. Protective Com., 3 Cir., 89 Fed. (2) 53; Wayne Un. Glass Co. v. Owens Ills. Glass Co., 4 Cir., 91 Fed. (2) 827. Stockholders are not ordinarily entitled to participate in a plan of reorganization if the debtor is clearly insolvent."

"It is the duty of the Court to scrutinize the plans of reorganization proposed for insolvent companies to make certain that the assets belonging to creditors are not by indirection diverted to stockholders."

Price v. Spokane Silver & Lead Co. (8 Cir.), 97 Fed. (2d) 237, 245;

In re N. Y. Railways Corpn. (2 Cir.), 82 Fed. (2d) 739;

In re Day & Meyer, Murray & Young (2 Cir.), 93 Fed. (2d) 657, 659;

In re Barclay Park Corpn., (2 Cir.), 90 Fed. (2d) 595;

Brunkenfeld v. N. Y. Rys. Corpn., 82 Fed. (2d) 740, 744.

Debtor corporation is insolvent. Its outstanding bonds represent a face value of $2,565,500. With due and unpaid interest on those bonds, the obligation under the trust indenture is about five million dollars.

"Its assets, subject to the bond issue, have been appraised at $465,000. The other assets of the Shipbuilding Company (its subsidiary) including cash, accounts receivable, etc., were appraised herein at $365,203.23. These last mentioned assets were not directly subject to the lien of the trust indenture securing debtor's bonds." [R. 206.]

Clearly it is thus one of "the corporate cripples."

In *Price v. Spokane Silver & Lead Co., supra,* that Court held:

"(15) We think it may be safely said that it was not the intention of Congress in enacting section 77B to place crutches under corporate cripples, fit subjects for liquidation, and send them out into the business world to be a menace to all who might purchase their securities or deal with them on credit."

In the case of *In re Day and Meyer, Murray & Young,* 93 Fed. (2d) 657 (2d Cir.), that Court said:

"It is the duty of the Court to scrutinize the plans of reorganization proposed for insolvent companies to make certain that the assets belonging to creditors are not, by indirection, diverted to stockholders. *In re* N. Y. Rys. Corpn., 2nd Circuit, 82 Fed (2) 739; *In re* Barclay Park Corpn., *supra.*"

In *Wayne United Glass Co. v. Owens Ills. Glass Co.,* 91 Fed. (2d) 827, decided August 6th, 1937, it was held on page 832:

"Where debtor is insolvent, stockholders consent to confirmation of plan is unnecessary, and the same is true of junior incumbrancers, who have no equity to be protected."

In *Reading Hotel Corpn. v. Protective Com.*, 89 Fed. (2d) on page 53, decided March 17th, 1937, that Court held:

> "Where property of a hotel corporation was subject to first and second mortgage * * * the Court properly approved reorganization plan whereby the corporation's property was transferred to bondholders, it being evident that stockholders had no equity, etc."

In *Brunkenfeld v. N. Y. Rys. Corp.*, 82 Fed. (2d), on pages 740 and 744, it was held:

> "8. Courts will scrutinize with care all plans of reorganization proposed for insolvent corporations, to make certain that assets belonging to creditors are not, by indirection, diverted to stockholders. Bankr. Act 77B. (b) (4)."

and

> "9. Stock equity in insolvent corporations may not be allowed to participate in any plan of reorganization which does not first provide for making creditors whole. Bankr. Act 77B (b) (4)."

In *Gerdes on Corporate Reorganization*, page 1740, is the following:

> "If the debtor is insolvent, no class of stockholders has an equity in the property of the debtor and no provision need be made for them in the plan." Citing
>
> *Reading Hotel Corpn. v. Protective Com.*, 89 Fed. (2d) 53; and
>
> 11 Fed. Suppl. 594. under 77B.

III.

That the Circuit Court Erred Under the Circumstances Disclosed in This Case, in Sustaining a Plan That Is Not Fair Because No Compensation Is Provided for Dissenting Bondholders for the Loss of Their Mortgage Lien, and a Plan Which Does Not Afford Them the "Adequate Protection" Required by Section 77B, Subdivision (b)(5) of the Bankruptcy Act.

The first portion of this point that the plan is not fair because no compensation is provided for dissenting bondholders for the loss of their mortgage lien, seems to have escaped construction or determination in the opinion of that Court. The Circuit Court does decide that there is "adequate protection" as contemplated in subdivision (b)(5) of 77B of the Bankruptcy Act.

As to "adequate protection" for dissenting bondholders, the Bankruptcy Act indicates "(1) the payment in cash." 77B (5) clause (5). Another provision of the Bankruptcy Act, *that of Section 57, clause (h),* is as follows:

> "The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors."

In *First National Bank v. Florshem,* 290 U. S. 504, at pages 519-521, the Supreme Court held:

> "The minority were entitled to payment in full."

(The minority were the petitioners in that case.)

Not even "a fraction of the face value of their holdings" is given to dissenting bondholders. It is the policy of the law, in instances of corporate reorganizations under 77B, to sustain UNIMPAIRED, that mortgage lien of dissenting bondholders.

In *Security-First Nat'l Bank v. Rindge* (9 Cir.), 85 Fed. (2d) 557, the Ninth Circuit Court of Appeals quotes a portion of subdivision (b), clause (5), and commenting upon it, decides, on page 561:

> "The legal value or property right in an obligation is the right to recover from the maker to the entire extent of his promise to pay. (Citing authorities.)
>
> "Manifestly, therefore, a plan of reorganization which gives bondholders only 40 per cent of the face value of their holdings does not make 'provision for the payment of their claims in cash in full.'
>
> "It is equally well settled that a plan of reorganization does not 'provide adequate protection' to creditors, within meaning of subdivision (b), clause (5), when it gives such creditors only a fraction of the face value of their holdings. In a recent proceeding under 77B, which came before this Court, the contention was urged that certain bondholders received 'adequate protection' by acquiring bonds of about half the face value of their former holdings. In rejecting the argument, this Court held that the protection for creditors specified in the Act must be 'completely compensatory.' Francisco Bldg. Corp. v. Battson, 9 Circ., 83 Fed. (2) 93. A like conclusion was announced by the 6th Circuit in *In re* Tennessee Pub. Co., *supra*.

"There is nothing in section 77B which authorizes a debtor to pay a secured creditor less than half the amount of the debt while retaining to its own use a portion of the property securing the debt. The right to retain a lien until the debt thereby secured is paid, is a substantive property right which may not be taken from the creditor consistently with the 5th and 14th Amendments to the Constitution. Louisville J. S. Co. v. Radford, 295 U. S. 555."

In *Horn v. Ross Island* (9 Cir.), 88 Fed. (2d) 64, the Ninth Circuit Court quotes in full, the paragraph above mentioned, of its decision in the *Rindge* case (85 Fed. (2d) on p. 561) and the notes that "Certiorari denied by U. S. Supreme Court, January 4th, 1937."

The Supreme Court of the United States, in 299 U. S. 18, affirmed, after having granted certiorari, the following doctrine announced in *In re Tennessee Publishing Co. v. American National Bank*, 81 Fed. (2d) 463:

"We confine ourselves to the provisions of subsection (b) (5) which outline a method for adjustment of claims of non-assenting creditors * * *.

"The right to have the mortgaged property devoted primarily to the satisfaction of the debt and the right to control the property meanwhile during the period of default, etc. These are substantive property rights and *any* invasion of them under the authority of the present statute, is as clearly violative of the due process clause of the 5th Amendment, as it was in the Radford case, 295 U. S. 555."

In *Texas Hotel Corporation v. Waco Development Co.*, 87 Fed. (2d) on page 400, that Court quoted and quite fully considered "paragraph (b)(5)" requiring "adequate protection" to secured creditors "for the realization by them of the value of their interests, claims or liens"; and there decided:

> "The Judge is not given the power, if it could be done, to substitute his judgment for the acceptance of a CLASS OF MORTGAGE CREDITORS. The words 'such protection', refer back to the words 'adequate protection for the realization by them of the value of their interests, claims or lien.'
>
> "Realization implies that what was *in prospect*, has COME TO HAND. Payment of the face of the claim IN CASH is the perfect realization of a money chose in action. But realization of the value of a claim or interest, may be adequately secured BY A SALE OR APPRAISAL OF THE THING which gives it value with the proportionate part of the value paid, or else the thing may be segregated and divided out *in kind*, or else LEFT UNAFFECTED for the holder of the claim to proceed according to his unchanged contract. Such are the instances specifically mentioned *as adequate* in subparagraphs (a), (b) and (c), paragraph (b) (5) of Section 77B."

Also:

> "Any plan confirmed under this clause without the consent of any class of claimants, must adequately provide for the realization by such claimants of the value of their claim."

IV.

That the Court Erred in Depriving of Their Substantive Rights, These Dissenting Bondholders, as a Minority Who Are Not Bound by Any Majority of Consenting Bondholders, However Large, and That Appellants Cannot Be Deprived of Their Rights as "Non-Assenting Creditors," by Any Kind of a Contract to Which They Are Not Actually a Party, Even Though More Than 75 Per Cent Have Consented to the Proposed Plan.

The opinion of the appellate court seems to have ignored this point and the decisions cited and from which quotations are furnished in appellants' opening brief (pages 25-33), are not referred to or construed in the opinion. This question of majority control (of a minority) is decided in those cases, in favor of the position occupied by appellants in this case.

The negative provision as a portion of subdivision (b) (5) "where less than two-thirds in amount of a given class have accepted the plan," is not involved in this case.

That is the opinion of appellee. In its reply brief, at the bottom of page 25, appellee asserts:

> "Here it is not necessary to apply the provisions of subdivision (b) (5) of section 77B of the Bankruptcy Act because more than two-thirds of the bondholders as a class have approved the plan."

In *First National Bank v. Florshem,* 290 U. S. 504, "95 per cent of all outstanding debentures were deposited under the plan" and that Court held that even such a majority

could not dominate the small minority or deprive it of its lien, denominated "a substantive right" and that "petitioners (the minority) were entitled to payment in full" (pp. 519-521).

This Supreme Court decision has been frequently cited in decisions by U. S. Circuit Courts of Appeals supporting the doctrine that

> "Even if a large majority of the creditors had approved the plan, that would be of no avail to sustain it."

The Supreme Court of the United States, in a comprehensive decision, in *Northern Pacific Ry. Co. v. Boyd*, 228 U. S. 482, on pages 502 and 503, said:

> "Contracts for reorganization made between bondholders and stockholders of corporations, insolvent or financially embarrassed, involving the transfer of corporate property to a new corporation, while proper and binding as between the parties, cannot, even when made in good faith, *defeat the claims of non-assenting creditors;* nor is there any difference whether the reorganization be made by *contract* or at a private sale, or consummated by a Master's Deed under a consent decree.
>
> "Even in the absence of fraud, *any* device whether by private contract or under judicial sale whereby stockholders are preferred to creditors, is invalid. 177 U. S. 683." (Italics ours.)

In another Supreme Court case, that of *Gilfillan v. Union Canal Co.*, 109 U. S. 401, is the following:

> "No majority, however large, can compel a minority, small though it be, to enter into such an agreement against their will, and, under the Constitution of the

United States it is probable that no statute of a state, passed after the bonds were issued, subjecting the minority to the provisions of the agreement, without their consent, would be valid."

The *Gilfillan* case was cited later as authority, in *Laura v. Barker,* 299 U. S. 521-522 and in 75 Fed. (2d) 261.

In that late case of *In re Day and Meyer, Murray and Young, Inc.,* decided in January, 1938 (93 Fed. (2d) 657), the Second Circuit Court of Appeals decided:

"That a large majority of bondholders approved an unfair plan of reorganization, was of no avail to sustain the plan."

The Ninth Circuit Court of Appeals, in *Horn v. Ross Island,* 88 Fed. (2d) 64, where there was only one bondholder, said:

"Dissenting bondholder is not bound by reorganization plan releasing debtor's property from lien of bonds where bondholders are to receive only the proceeds of part of mortgaged property even though such plan be approved by bondholders as a class."

Also:

"A corporate reorganization plan whereby bondholders were to be paid the proceeds of part of the property subject to trust deed and were to release the remainder subject to trust deed, to debtor and to debtor's general creditors, could not be approved so as to deprive objecting bondholder of his lien on any of the property subject to trust deed, although 75½ per cent of the bondholders approved the plan. Bankruptcy Act 77B; Constitutional Amendments 5 and 14, 11 U. S. C. A. 207."

In the latest case on this subject (Oct., 1938), that of *Sophian v. Congress Realty Co.*, 98 Fed. (2d) 499, on page 502, the 8th Circuit Court held:

> "(5) Even if a large majority of the creditors have approved a plan, that is of no avail to sustain it, if it is unfair, discriminatory, inequitable or not feasible. *In re* Barclay Park Corpn., *supra*, 90 Fed. (2) 595; First National Bank v. Florshem, 290 U. S. 504, 517-519, 54 S. Ct. 298, 303, 304, 78 L. Ed. 465, 90 A. L. R. 391; *In re* Day and Meyer, Murray & Young, Inc., *supra*, at page 659; Price v. Spokane Silver and Lead Co., *supra*, at page 245.
>
> "(6) In many reorganization proceedings such as this, the rights of small, scattered and thoroughly discouraged bondholders are involved. Often they are unable to employ counsel to protect their rights. It is of great importance that the courts of bankruptcy shall see to it that they are not unfairly dealt with."

Another late case (June 13th, 1938), that of *Price v. Spokane Silver & Lead Co.* (8 Cir.), 97 Fed. (2d) 237, on page 245; held:

> "Even if a large majority of the creditors had approved the plan, that would be of no avail to sustain it. First National Bank v. Florshem, 290 U. S. 504, 54 S. Ct. 298, 78 L. Ed. 465, 90 A. L. R. 391; *In re* Barclay Park Corporation, *supra*."

In the Ninth Circuit Court case of *Security-First Nat. Bank v. Rindge* (85 Fed. (2d) 577), the "bondholders committee * * * acquired more than 90 per cent of the outstanding bonds."

In *Texas Hotel Corpn. v. Waco Dev. Co.*, 87 Fed. (2d), on page 400, that Court decided:

> "The decree under review is finally rested upon this provision. We do not construe it to authorize the Judge to approve any plan which he thinks fair and equitable. If this were intended the statute could have been made much simpler and shorter. In this case, he thought it fair and equitable to reduce the interest, even retroactively, and to extend for seven years or more, the maturity of this mortgage debt, but if there had been a single, unwilling mortgagee, that plan could not have been constitutionally imposed. Louisville Joint Stock Bank v. Radford, 295 U. S. 555."

In 28 *Am. Law Reports*, on page 1197, is the following:

> "A majority of the bondholders of a company *cannot*, upon its reorganization, *compel a minority* to accept securities of the new company, is supported by the dictum of the court in Canada Southern R. R. Co. v. Gebhard, 109 U. S. 527, and
>
> "No majority, however large, can compel a minority, small though it be, to enter into such an agreement against their will and under the Constitution of the United States it is probable that no statute of a state, passed after the bonds were issued, subjecting the minority to the provisions of the agreement, without their consent, would be valid."

In any cases where reorganization was permitted subjecting a minority to the will of the majority, it is apparent that in every instance they were RAILROAD CASES or possibly a Public Utility Company. And in such cases, the controlling factor was always "the public interest." THIS DEBTOR IS A PURELY PRIVATE CORPORATION, operating for private profit and in no way is "the public interest" involved. [R. 328.]

In such public utility reorganizations, the rule is stated as follows:

> "Bondholders, especially of public service corporations such as railroad companies, may be regarded as having contracted with reference to the public interest, which may best be served by continued operation of the utility through a reorganization scheme, and the court might take the view that an exchange of securities required by a plan of reorganization to which the majority of the bondholders assented, did not, under these circumstances, violate the contract of the non-assenting bondholders. Especially might this be true where the exchange of securities of the old company, was for bonds of substantially the same character and value of the new or reorganized Company. But the case would be much weaker if the form of the claim were changed so that a bondholder in the old company was required to surrender his securities in exchange for stock in the new Company even though he retained the same relative rights of rank", etc. 28 Am. Law Reports (anno.), page 1196.

> "The bankruptcy power is subject to the 5th Amendment (to the Constitution) and that under the bankruptcy power, Congress cannot authorize the Bankruptcy Court to take for the benefit of the debtor rights in specific property acquired by the creditor."

(This quotation is taken from the case of *Horn v. Ross Island*, 88 Fed. (2d) 64, on page 65 of that decision, and is from the *Radford* case.)

In the *Horn* case *(supra) syllabi:*

> "A dissenting bondholder is not bound by such a plan even though it be approved by more than two-thirds of the bondholders as a class. See Collier Supp. 77B., Am. B. R. Digest section 1279." See page 66 of the decision.

In *First Nat'l v. Florshem,* 290 U. S. 504, there was "95 per cent of all outstanding debentures" and they could not deprive the small minority of its lien. Pages 519-521.

In the recent case of *In re Day & Meyer, Murray & Young,* 93 Fed. (2d) 657, there was 95 per cent consenting, yet there held:

> "That a large majority of bondholders approved an unfair plan of reorganization, *was of no avail to sustain the plan.*"

In the *Horn* case *(supra)* there was "75½ per cent" who could not "deprive objecting bondholder of his lien on any of the property subject to the trust."

In *Security-First Nat'l v. Rindge L. Co. (supra)* there was more than 90 per cent of outstanding bonds.

In the case of *Texas Hotel Corpn. v. Waco Develpt. Co.,* 87 Fed. (2d) on page 400, in addition to deciding that the "judge" cannot approve "*any* plan which he thinks fair and equitable." And "if this were intended, the statute could have been made much simpler and shorter," and also holds:

> "But if there had been a single, unwilling mortgagee, that plan could not have been constitutionally imposed. (Citing Louisville Joint Stock Co. v. Radford, 295 U. S. 555.)"

In *Northern Pacific Co. v. Boyd,* 228 U. S. 482, holding that "no contracts involving the transfer of corporate property to a new corporation" can "defeat the claims of non-assenting creditors" even "though made under a consent decree."

V.

That the Court Erred in Depriving Appellants of the Interest Promised in the Bonds, Also Represented by Coupons Attached to the Bonds and an Integral Part of Those Bonds and for Which No Compensation or Consideration of Any Kind Has Been Allowed or Extended to Dissenting Bondholders.

We are unable to find any determination of this important principle of substantive law in the opinion of the Circuit Court. That no provision for the payment of interest due and unpaid on the bonds is made in the plan and that such interest will not be paid, is admitted in the briefs of all counsel and clearly shown in the record furnished by the transcript. This is not denied by debtor. The decisions cited and the quotations which are furnished show that petitioners are entitled to the interest due on the bonds—as much so as to the principal amount due on the bonds.

In the plan as amended, Debtor Corporation explicitly limits its offer of 250 shares of new capital stock to "the principal amount of the bonds outstanding." [R. 59.] That expression *excludes* the interest; this is admitted by Debtor and the entire record shows that Debtor Corporation does not intend to allow anything for the due and unpaid interest—now equal to the amount due as principal on the bonds. Petitioners have never received and have never waived that interest.

THE BANKRUPTCY ACT, SECTION 77B, subdivision (b) (10), is as follows:

> "In case of secured claims entitled to the provisions of clause (5) of this subdivision (b), the value of the security shall be determined in the manner provided in Section 57, clause (h) of this Act."

Section 57, clause (h), is as follows:

> "The value of securities held by secured creditors shall be determined by converting the same into money, *according to the terms of the agreement* pursuant to which such securities were delivered to such creditors."

"The terms of the agreement," in this case the bond itself, contains an express provision promising interest at 7½ per cent per annum—and without which (of course) nobody could have been induced to buy any of the bonds.

In *In re Day and Meyer* (93 Fed. (2d) 657) the Second Circuit Court of Appeals said:

> "The arrears of interest is also secured (to bondholders) and entitled to priority over the general creditors and preferred stockholders. *In their interest claims the bondholders should be protected.* They are not protected under the plan for they are given only common stock. Such common stock is given share for share to the old preferred stockholders who have no equity in the corporation and furnish no new consideration. Both the old preferred stockholders and the old common stockholders *should be subordinated entirely,* since the corporation, being insolvent, belongs to the creditors alone.
>
> "A reorganization plan providing that first mortgage bonds be reduced to one-half of their principal amount * * *, and eliminating the total amount of interest past due on the bonds, WAS UNFAIR and should not have been confirmed * * * since the plan did not preserve priorities and deprived bondholders of their lien." (Emphasis ours.)

Those two features, of reduction of amount of bonds to one-half and of elimination of the interest past due on the bonds, were the only issues involved in that case.

In *American Iron & Steel Co. v. Seaboard Airline*, 233 U. S. on page 266, the Supreme Court refers to "the general rule" of allowing interest to the time when the "property of an insolvent is *in custodia legis*" and then considers that the longer interest (to time of payment of the claim) would be due "if all claims were of equal dignity and all bore the same rate of interest from the date of the receivership to the date of final distribution." Then in that case the Supreme Court added:

> "But the rule did not prevent the running of interest during the receivership. (Citing) Johnson v. Norris, 190 Fed. 459, 460, where the Court held that creditors in bankruptcy were entitled to interest accruing after adjudication." (Page 267 of 233 U. S. Reports.)

In the case at bar the only unpaid creditors are the bondholders and their claims "all bear the same rate of interest and are of equal dignity." [R. 13.]

> "But the rule in equity receiverships is that upon interest bearing claims, having priority, interest continues to run until the actual payment of the claims."
>
> *In re Semon*, 11 Fed. Supp. 18.

> "Such is the case where there has been payment of interest on their bonds" and "creditor secured by a lien under a contract providing for interest, is entitled to interest on his claim to the date of payment even though inferior creditors may receive nothing."
>
> *Gerdes on Corporate Reorganizations*, Vol. 2, p. 974, citing
>
> *Southern Ry. v. Carnegie Steel*, 176 U. S. 257.

To this same effect is *Board of Commrs. v. Bernardin*, 74 Fed. (2d) 809.

VI.

That the Circuit Court Erred in Sustaining a Plan Which as to Dissenting Bondholders, Is Neither Fair, Equitable, Nor Feasible, and Is Discriminatory in That It Discriminates Unfairly in Favor of Unsecured Creditors and Present and Future Stockholders of Debtor and Against the Rights of Appellants as Dissenting Bondholders.

The opinion of the Appellate Court evidently considers the plan in this case, which deprives dissenting bondholders of their mortgage lien, denies them payment of any interest due and unpaid on their bonds, awards 23 per cent of the new capital stock to present stockholders of an insolvent corporation and would award to appellants one-eighth of the face value of their bonds in shares of capital stock of a new corporation, *to be fair and equitable.* This, we respectfully submit, is opposed to the substantive law involved in this case and as it has been established by the Supreme Court and by a number of the decisions of the United States Circuit Courts of Appeals.

In the opinion of the Appellate Court is the following:

> "Also, that the Government is planning the construction of warships and auxiliary vessels and that the shipyard of the subsidiary company is equipped for the building of vessels of the proposed type." [R. 377.]

This is opposed to the findings of the trial court. Adopted by the trial court, as shown on page 71 of the transcript, is the following:

> "If a shipbuilding construction programme is undertaken, it will require about $500,000. to place the four building ways in first class condition, or, if all

four are not rehabilitated at one time, about $150,000. for the first one and lessening graduated amounts for the other three, but not to exceed $500,000. in all. Only a small amount of money will be required to put the *rest* of the plant in first class order." [R. 71.]

On page 72 of the transcript is the following:

"The plant of the Los Angeles Shipbuilding & Dry Dock Corporation is not large enough to construct naval vessels but it could build auxiliary vessels. Much of our present merchant marine is obsolete and must be replaced in a few years." [R. 72.]

While the foregoing is designed to build up a remotely possible "equity" in the present stockholders, it shows one thing very clearly and that is that *new* money is required to rehabilitate the properties of debtor. NO NEW MONEY IS OFFERED. Debtor and its present stockholders are quite silent on that subject. Evidently debtor has some doubts of any necessity for new or additional money because it asserts in connection with the 170,000 shares as the unappropriated balance of its *new* stock (par value $1.00 per share):

"to be sold for cash for the purpose of providing new operating capital *in the event it is required by the Company.*" [R. 12.]

"The proposed plan set up in the debtor's original petition herein for reorganization does not provide for the furnishing of any *new* money by the old Class A shareholders." [R. 86.]

This plan discriminates against the appellants as dissenting bondholders. In its discrimination against dissenting bondholders, the District Court's confirmation of this plan runs *contra* to

Northern Pac. Ry. Co. v. Boyd, 228 U. S. 482;
First Nat'l Bank v. Florshem, 290 U. S. 504;
Gilfillan v. Union Canal Co., 109 U. S. 401;
Horn v. Ross Island, 88 Fed. (2d) 64;
In re Day & Meyer, 93 Fed. (2d) 657;
Texas Hotel Corp. v. Waco Dev. Co., 87 Fed. (2d) on page 400, and other cases quoted in preceding pages of this brief.

In *Northern Pacific Ry. Co. v. Boyd,* 228 U. S. 482, a railroad case at that and where the "public interest" was concerned, the Court decided:

"Contracts for reorganization made between bondholders and stockholders of corporations, insolvent or financially embarrassed, involving the transfer of corporate property to a new corporation, while proper and binding as between the parties, cannot, even when made in good faith, defeat the claims of non-assenting creditors; nor is there any difference whether the reorganization be made by contract or at a private sale, or consummated by a Master's Deed under a consent decree.

"Even in the absence of fraud, any device whether by private contract or under judicial sale whereby stockholders are preferred to creditors, is invalid. Citing 177 U. S. 683."

That such a plan is not fair and not equitable is shown by the decisions cited in previous pages of this brief.

For "feasibility"—the District Court has determined: 1. That present management—the old stockholders—are best equipped to carry on the shipbuilding business. In view of the fact that they have failed for the last ten years, present stockholders seem to have indicated their inability to succeed with present equipment. 2. That prospects for future business are good and that the stockholders might eventually profit in future years by allowing the old stockholders to continue the business through the medium of a new corporation. In order to do business in the future, these old stockholders must have their assets freed from the mortgage lien.

Even with such a delightful consummation, the "feasibility" is dependent upon the expenditure for necessary repairs and enlargements of "not to exceed $500,000." [R. 71.]

Present stockholders do not offer to expend any money or furnish "additional capital" for these necessary repairs. They do not offer to furnish "any new money." [R. 86.]

Feasibility cannot be based upon prospects of future profits however alluring they may seem to the Court or to a Special Master. This is shown by

Reading Hotel Corpn. v. Protective Comm., 89 Fed. (2d) 53;

Texas Hotel Corpn. v. Waco Developt. Co., 87 Fed. (2d) p. 400;

Wayne United Glass Co. v. Owens-Ills Co., 91 Fed. (2d) 827;

In re Vicksburg, 22 Fed. Supp. 490, decided April 18, 1938;

In Matter of Murrell, 29 Am. Bankr. Reports (N. S.) 290, and other cases.

In *Price v. Spokane Silver & Lead Co.*, 97 Fed. (2d) on page 245, that Court said (June 13th, 1938):

"(11) The court also erred in assuming that if, upon its face, the plan proposed appeared to be feasible, it was to be approved unless the objecting creditors could show that it was not feasible."

And also in that case but on page 247:

"(17) The *debtor* having failed to show that the proposed plan of reorganization was either fair, equitable or feasible, and also having failed to show that the stockholders of the debtor have any real interest in its assets or a right to participate in the plan of reorganization, we think the objecting creditors were entitled to a dismissal of the debtor's petition on the ground that it had not been filed in 'good faith.'"

VII:

That the Court Erred in Not Deciding the Doctrine of Estoppel of Debtor Which Is Specifically Pleaded and in Which Connection Appellants Rely Upon Section 5 of Article 2, Page 29 of the Trust Indenture and Which Appears Fully in the Transcript in This Case, Which Transcript Was Required by the Amended Praecipe and Which Were Consented to by All Counsel in This Case.

Squarely presented in the Transcript of Record and in the briefs is the question of estoppel. Appellants had hoped that the Appellate Court would pass upon that question. In its opinion, the court does not seem to have done so. That issue was specially pleaded in the written opposition to the petition for reorganization, was tried and passed upon by the trial court and is embodied in the transcript and the briefs.

By Way of Estoppel Herein.

The question presented in Case's Amendment to his Answer, by way of estoppel in this proceeding [R. 55, 56, 259, 261], comprehends the explicit obligations assumed by this Debtor to reassure and induce *the public* to buy its bonds and to protect its Trustee, as the same appear in the Trust Indenture, as SECTION 5 OF ARTICLE 2, on page 29 thereof, as follows:

> "SECTION 5. That they will not apply for nor avail themselves of injunction or stay proceedings, OR PLEAD or in any way take advantage of any valuation law, apportionment law, *appraisement* law, stay law, OR OF ANY OTHER LAW, whether now in force or

which may hereafter be enacted, which may in *any way,* ALTER, IMPAIR OR IMPEDE *the rights or remedies* of the holders of the bonds issued hereunder, or of the TRUSTEE as herein provided, or which shall effect or change the time, place, means or mode of perfecting or enforcing such rights or remedies; and THEY HEREBY EXPRESSLY WAIVE ALL BENEFIT AND ADVANTAGE OF ANY AND ALL SUCH LAWS.

"That they expressly waive the equity of redemption or right of repurchase, in case of any foreclosure sale hereunder, and agree that any and all such sales may be made free from any and all such rights." [R. 259.] (Italics ours.)

This section as to both of the makers of that Trust Deed—one of them the Debtor, was rather comprehensive—rather reassuring to the public and the prospective bondholders whom the Corporation hoped would be reassured thereby. To have these corporations, one the parent and the other the wholly owned subsidiary, expressly waive, in excellent legal phraseology, all of their rights to oppose, contest or even question the legal standing of the bonds, MUST have been calculated by this Debtor to persuade the public, which it intended to solicit, to buy its bonds.

"If debtor corporation thinks it may resort to *one* provision of its trust deed (relating to a ¾ths majority) that of section II, art. 9, page 79, it should also be bound by the earlier provision of that same trust deed, viz.: sec. 5, art. 2, page 29 in which it promises 'not to impair or impede the rights or remedies of holders of the bonds.'"

Section 5 on page 29 of the Trust Deed is a direct obligation not to question, contest or oppose the legal status of these bonds which the Debtor voluntarily assumed—to induce prospective bondholders to feel that they would be protected thereby.

Before the Chancellor, Debtor must seek equity with clean hands. It seems as if Debtor cannot, in good conscience, now gainsay its own assertions and avoid its own acts.

That section was an important representation made by Debtor to induce prospective bond buyers and firms of underwriters to purchase the bonds and to make them feel safe as against any later claims which Debtor might have made questioning the validity or due execution of the bonds. It constitutes an important *waiver* by the mortgagor of legal or equitable rights which it might later have asserted. The legal phraseology employed in that section is very comprehensive. It includes future contingencies such as "any other law, whether now in force or which may hereafter be enacted, which may *in any way* alter, impair or impede the rights *or remedies* of the holders of the bonds issued hereunder, or of the trustee as herein provided." Quite common, and deemed quite necessary, are such assurances in bond issues. They are an assurance of safety to the bondholders and also to the trustee. Without doubt those provisions were a substantial inducing cause to secure purchasers of the bonds.

This provision of the trust deed was intended to be, and was, both as to prospective purchasers and to the trustee, Debtor's positive assurance of the validity of these bonds, and that as to Debtor they were inviolate.

Authorities on the Doctrine of Estoppel.

This section 5, article 2, page 29 of the trust indenture seems to present an "estoppel in *pais*". Often commingled are the doctrines of "estoppel in *pais*", "equitable estoppel" or "*quasi* estoppel".

In a very recent case, that of *Robbins v. United States*, 21 Fed. Supp. 403, the issue of January 24th, 1938, it was held:

> "The doctrine of "equitable estoppel or *quasi* estoppel" has been extended to prevent a wrong being done whenever, in good conscience and honest dealing, a party ought not to be permitted to *repudiate* a previous statement, declaration or action."

Estoppel Against Mortgagor.

Conforming to the general rule a mortgagor is estopped to assert anything in derogation of the rights which the instrument purports to convey, as that he had no title at the time of executing the mortgage, that there is an outstanding title in a third person, that the estate mortgaged was other or less than an estate in fee simple, that the instrument was defectively executed. *Am. Water Works v. Farmers L. & T. Co.*, 73 Fed. (2d) 956.

Language of mortgage participation certificates, issued by assignee of mortgages, that assignor guaranteed that holders' interests in bonds and mortgages were not subordinate to other shares or prior interests, must be given effect as *promisor* reasonably knew holders would understand it, and certificates construed according to their terms, regardless of private arrangement between assignor and assignee; they being estopped to assert undisclosed understanding altering such terms to holders' detriment. *In re The Westover, Inc.*, 82 Fed. (2d) 177.

Where irrigation district alleged that bonds sued on were illegally issued, reply denying allegations and attaching copy of notice for special election at which bonds were voted, reciting that purpose was to issue bonds for things which answer alleged bonds were issued for, constituted good plea of estoppel *by recitals in bonds.* (C. L. Colo. 1983 *et seq.*) *Divide Creek Irr. Dist. v. Hollingsworth, 72* Fed. (2d) 859.

"Estoppel" is a means of repose, promotes fair dealing, and can not be made an instrument of wrong or oppression. Like the statute of limitations it is a conservator. *Daniels v. Tearney* (W. Va.), 102 U. S. 415; 206 N. W. 741, 744, 114 Neb. 134.

Doctrine of estoppel requires consistency of party's conduct when inconsistency would work substantial injury to other party to transaction. *Julian v. Nicholson, 72* Fed. (2d) 35.

> "The doctrine of equitable estoppel is founded upon equity and good conscience, and the party claiming the estoppel must have done something, *paid something* or in some way changed his position for the worse, so that he will not be left or cannot be put back in his former position in case the other party is allowed to assert his original rights."
>
> *Nell v. Dayton,* 45 N. W. 229, 43 Minn. 242.

> "An estoppel in *pais* is very well defined by Nelson, J. in Welland Canal Co. v. Hathaway, 8 Wend. 479, 483. He says: 'As a general rule a party will be concluded from denying his own acts or admissions which were expressly designed to influence the contract of another, and did so influence it, and when such denial will operate to the injury of the latter.'"
>
> *Payne v. Burnham,* 62 N. Y. 69, 73;
>
> *Piper v. Gilmore,* 49 Me. 149.

Argument on the Facts.

The facts of this case are as follows:

1. The petition of Debtor and orders of the District Court show that the primary purpose of this proceeding is to cancel and destroy the first mortgage liens of bondholders which are secured by the trust indenture [R. 12, 13, and on 16 (Sub. 6)] showing that the "holders of debtor's bonds are the only creditors and persons whose claims and interest will be affected by the Plan." All other creditors are to be paid in cash. [R. 16, 207.]

2. The bondholders would thereby be deprived of their substantive rights among which are: the right to foreclose their mortgage, have a judicial sale of the pledged assets under the direction of the Court, to bid at such sale on the properties pledged in the trust indenture, to have the rents and profits in the meantime and would lose their right to realize on a deficiency claim against the present very substantial stockholders. [R. 103, 135, 109.]

3. The bondholders would lose all interest due and unpaid on the bonds since Feb. 1st, 1929, and premiums promised in the bonds. [R. 59, 90.]

4. The Debtor is insolvent "both in the equity sense and in the bankruptcy sense." [R. 140.]

5. The present stockholders would receive under the proposed reorganization, 23 per cent of the capital stock of the new company and in addition, would receive a proportionate award to them of the new capital stock as owners of a very large percentage of the first mortgage bonds—although debtor is insolvent. [R. 58, 59, 88, 209.]

6. That the leasehold interest of Debtor at Los Angeles Harbor is valued by it at the sum of One (1)

Dollar; that it comprehends 68.54 acres of very choice water frontage and for this Debtor is paying $21,500 per year. On only a five per cent basis of yield, that leasehold interest is worth $430,000—of which sum 5 per cent is exactly $21,500. This lease runs to the year 1952, is subject to renewal which would undoubtedly be granted. [R. 70, 249, 250.]

7. That Thomas K. Case and Adele B. Cowan are secured creditors and dissenting bondholders; that they have never consented to any proceedings by Debtor in the past or present time and did not consent to the reorganization proceedings in 1930 under which Debtor became a "Limited" corporation. [R. 112, 113, 153.]

8. That Case's bonds, representing a par value of $13,500 and Cowan's bonds, representing a par value of $5,000, were all acquired by them prior to the year 1930, during which year and thereafter the supplements to the trust deed were created as Debtor's Exhibits F, G, H, and I. [R. 83, 110.]

9. That petitioners have never received any of the principal on their bonds and no interest since February 1st, 1929, have never joined in the release of the present stockholders of their liability on a deficiency claim, have received no shares of the capital stock of Debtor for any purpose and have not since received anything at any time. [R. 70, 247, 255.]

10. That petitioners, as dissenting creditors, claim by way of estoppel, that Debtor is estopped from indulging *as against them* in this proceeding for reorganization and all proceedings which would "in any way, alter, impair or impede the rights of the holders of the bonds issued hereunder," and rely for the purpose of said estoppel

upon Section 5, Article 2, page 29, of the trust indenture securing said bond issue. [R. 55, 56, 259-261.]

11. That Debtor claims that appellants, as secured creditors and dissenting bondholders, whose undeposited bonds represent a par value of $18,500, are dominated and controlled herein by more than 75 per cent of depositing bondholders the "consent" of which, to this proceeding, has been filed by the trustee named in the trust indenture, and in that connection Debtor relies upon Section II, Article 9, page 79, of the trust deed. [R. 261.]

12. The Debtor will acquire, free from the mortgage lien, all properties pledged in the trust deed, for the benefit of its stockholders and unsecured creditors. [R. 105, 154, 206.]

13. The only offer of Debtor is that of 250 shares of its new capital stock (par value $1 per share) for each $1,000 bond, "principal amount of the bonds," and makes no allowance for due and unpaid interest on the bonds. [R. 59, 90.]

This Plan Is Not Fair or Equitable

That the plan in this case is not fair or equitable seems to us quite evident from the determinations in the many cases cited in our preceding pages.

It destroys the first mortgage lien with the other substantive rights and gives present stockholders an equity to which they are not entitled. The plan makes no allowance whatever for accrued, due and unpaid interest on the bonds and is based "upon an unfair and inadequate appraisal" which does not involve or consider the very valuable Harbor Lease. Without that leasehold, Debtor could not have sold these bonds nor have secured authori-

zation to issue $3,500,000 in bonds or have transacted any of its business.

To Bethlehem Steel and other huge corporations now operating on the Pacific Coast, some of which are referred to in the Master's Report, for Dry Dock, Shipping, Manufacturing and other purposes, that exceedingly choice harbor frontage has an immense value.

The Plan takes no cognizance of that and yet it is the most valuable asset which debtor owns and hopes to again secure free from this mortgage lien. Debtor carries this valuable asset on its books at $1. [R. 139.]

In addition to the $830,203 in assets which Debtor concedes it owns, there should be an appraisement of the L. A. Harbor frontage lease of 68 acres for which Debtor is paying $21,500 per year. That payment shows that the leasehold interest is worth at least $500,000. It is widely known publicly and the records of the L. A. Harbor Board will show, that all of the valuable and of the choice water frontage there, has been leased and at the present time an appraisement should show that the leasehold interest is worth a million dollars and perhaps more—and that it is of increasing value. [R. 249, 250.]

Even a million dollars, although added to the $830,203, of the appraisement in this case, would not change Debtor's position here, as an insolvent corporation, it might make some very substantial difference in the value of the securities which are subject to appellants' liens. We are mindful of the dicision of the Ninth Circuit Court of Appeals in the concluding portion of the Court's decision in *Horn v. Ross Island*, 88 Fed. (2d) 64, concerning an "appraisal of the property securing such bonds."

Debtor's Unfair Offer.

For the appraised assets of $830,203. Debtor has created 1,000,000 shares of new capital stock, of which it offers:

(1) To BONDHOLDERS:

"641,375 shares of five per cent, non-cumulative, preferred stock (par value $1 per share) shall be issued in exchange for outstanding bonds ($2,565,-500) at the rate of 250 shares of said preferred stock for each $1,000 PRINCIPAL AMOUNT of bonds outstanding;"

(2) To PRESENT STOCKHOLDERS, known as "class A. shareholders":

"188,625 shares of common stock (par value $1) shall be issued to the Class A. shareholders. The shares of both classes of said stock shall have a par value of $1 per share. All shares having equal voting rights per share." [R. 209.]

These Class A shareholders are the present stockholders concerning whom the Special Master reports [R. 85] "are persons who have been in the past and who are now, active in the business operations of the Debtor and its subsidiaries."

The new company has one million shares. Of this 641,375 shares are preferred stock. The balance constitutes COMMON stock of 358,625 shares. Debtor's offer to present stockholders of 188,625 shares of common stock, still leaves undisposed of 170,000 shares of com-

mon stock. The Final Order of the District Court disposes of the common stock, actually 358,625 shares, as follows:

> "(b.) The said common stock of the new company shall be distributed on a pro-rate basis to the holders of Debtor's Class A. stock." [R. 345.]

"Class A. shareholders" could thus acquire more than *one-third* of all of the new capital stock—as present stockholders of Debtor. *In addition:* these same present stockholders would be awarded AS OWNERS OF OUTSTANDING BONDS, more than one-third of the outstanding bond issue. As appellants estimate it, they would acquire more than two-thirds of the entire capital stock of the new corporation.

> "Some of the old Class A. stockholders of the Debtor are bondholders." [R. 93.]

The dividends on the preferred stock are "non-cumulative."

Referring to this fact, the special master in his report states:

> "The modified plan does not provide for cumulative dividends for the reason that if the business is not prosperous, or is only moderately prosperous, such arrangement might be detrimental." [R. 96.]

Debtor's refusal of cumulative dividends shows how uncertain and unpromising it really regards future business prospects. The common stock carries the same 5% dividends as the preferred. All new stock will have "equal voting rights per share." [R. 209.]

Under This Unfair Plan, Much Money Is Needed to Enable New Company to Operate.

To continue in business with even the hope of future profits the new company must have much money. The Special Master estimates on page 71 of the record:

> "If a shipbuilding construction programme is undertaken, it will require about $500,000 to place the four building ways in first class condition or, if all four are not rehabilitated at one time, about $150,000 for the *first* one and lessening graduated amounts for the other three, but not to exceed $500,000 in all. Only a small amount of money will be required to put *the rest* of the plant in first class order." (The latter presumably in addition to the large sums.)

Likewise, on page 72 of the record:

> "The plant of the Los Angeles Shipbuilding & Dry Dock Corporation is not large enough to construct naval vessels but it could build the auxiliary vessels. Much of our present merchant marine is obsolete and must be replaced in a few years."

While the foregoing is purely conjectural, designed to build up a remotely possible "equity" in the stockholders, it shows *one* thing very clearly and that is that NEW MONEY is required to "rehabilitate" the properties of Debtor.

> "The proposed plan set up in the Debtor's original petition herein for reorganization does *not* provide for the furnishing of any *new* money by the old Class A. shareholders." [R. 86.]

There is no offer by the present stockholders to advance this necessary money, or any part of it. Without this new money in large amounts, Debtor will be in exactly

the same position if reorganized, *as it is in at present.* The evidence shows and the master's report indicates, that these are wealthy stockholders, yet they do not think enough of this corporation, or of its prospects, to even furnish "the compliance bonds" required on Government work.

These same dominating stockholders (also later bondholders) were willing to promise to pay 7½ per cent per annum, in 1924, as interest on these bonds to induce their sale, then sell the bonds for $3,210,000, then employ for several years as president, one George A. Armes with all the failures and the expenses incident therewith [R. 74, 76] and now they want the bond issue cancelled and to keep the pledged assets as their own. The 5 per cent dividends on the new preferred and common stock are a hazy vision. As "non-cumulative," there is not a binding promise unless profits are not all consumed by and under the same management and control. As of yore, since Feb. 1st, 1929, failure to *call* and pay for the bonds, failure to pay interest on them, failures to succeed in their business management, these same stockholders hope to have adopted their utterly unfair plan of reorganization. With multi-millionaire Daniel Murphy at their head, as "dominant factor in said Bank (the trustee), and in the Debtor corporation" and who "has been a large stockholder of Debtor ever since its incorporation and has acted as director thereof, personally and through his agent and employee, H. K. Bagley, and that said Daniel Murphy is now and for many years last past has been a director of Security-First National Bank of Los Angeles" [R. 109], he and this trustee Bank, insist that they shall again own the pledged assets which the decisions show now belong to the bondholders. The long default in the pay-

ment of interest or principal on the bonds, makes these bonds due and payable now, in the case of this insolvent corporation. There is no hope of inducing this trustee bank to act, as it has the right to do and as its duty requires it to act, under the provisions of the law and the trust indenture.

> "The said Daniel Murphy received a release from stockholders' liability and 21,670.50 shares of Class A. stock of debtor corporation" (out of a total of 57,000 shares). [R. 109.]

Showing that the rights of bondholders cannot be affected by prospective profits, or their right to foreclose be even delayed, the following cases are conclusive, that, as to them, prospects of profit are of no legal effect:

In *Security-First Nat'l Bank v. Rindge* (9th Circuit), 85 Fed. (2d) 557, Subdivision 5. of the decision:

> "Section 77 B. subd. (A), 11 U. S. C. A., section 207, gives the Court equity powers but it does not purport to alter long established incidents of property by introducing a vague and indefinable 'equity' into the proceedings."

The sole purpose of offering prospective or future profits, is to create an "equity" in the stockholders which, in the instance of an insolvent corporation, is not permitted.

> *Horn v. Ross Island* (9th Circuit), 88 Fed. (2d) 64;
>
> *Reading Hotel Case,* 89 Fed. (2d) 53; decided March, 1937, even though all of the mortgaged property was "transferred to bondholders," it was held that they did not have to wait for prospective profits but could proceed with their right to foreclose.

In re Day & Meyer, 2nd Circuit, New York, decided January 3rd, 1938, 93 Fed. (2d) 657, held:

> "A reorganization plan providing that first mortgage bonds be reduced to one-half of their principal amount, and that the equity thereby created by represented by issuance of new preferred and common stock (like case at bar) and eliminating the total amount of interest due on the bonds (also as in case at bar) was unfair and should not have been confirmed * * * since the Plan did not preserve priorities and deprived bondholders of their lien."

In *Wayne Un. Glass Co. v. Owens-Ills.,* 91 Fed. (2d) 827—Aug. 6, 1937:

> "Where stockholders and junior incumbrancers have no equity because of Debtor's insolvency, they cannot complain of dismissal of petition for reorganization."

Preble v. Wentworth, 84 Fed. (2d) 73;

Louisville J. S. Co. v. Radford, 295 U. S. 555, and other cases.

The prospects of future profit, as they viewed them, and their appreciation of the present management of Debtor, seem to have largely influenced the trial Court as well as the Special Master, to find the plan fair and feasible. [R. 85.] The final order repeats these views.

It is impossible to believe that depositing bondholders would *personally* "consent" to the cancellation of their first mortgage bonds for only *one-eighth* of the total amount of their claims in shares of stock in a reorganized corporation—with absolutely no cash and not even one-half of their first lien bonds preserved to them, with the priorities that accompany them.

No one can honestly place any cash value on those new shares of one dollar par value stock. There is no *market* value to those new shares. [R. pp. 247, 249-251, 256.]

This Debtor is in disrepute, widely known, is on the list for investigation by the Sabbath Congressional Investigation Committee and has received much unfavorable notoriety. [R. 247, 248.] Reorganized, it would become a dangerous "corporate cripple."

If the District Court is correct here, any private corporation could be authorized to cancel its large bonded debt, and issue to the bondholders nothing more than shares of stock in a new corporation. That would be to relegate first mortgage lien holders (the highest position), to the grossly inferior position of stockholders in a newly organized company—the lowest position—not even equal to that of a creditor who can sue upon his claim. The new company controlled always by the old stockholders could secure a new bonded debt—to bind its stockholders again and thereafter come into the bankruptcy court and have that bond issue cancelled and new stock issued therefor.

These wealthy stockholders conspired, in the year 1930:

(1) To freeze out, by assessment, all other stockholders, setting the example themselves by not paying the assessment. As the special master puts it "The principal features of this reorganization were as follows: the old stock of the corporation was wiped out by assessment." [R. 75.]

(2) Then these dominant stockholders effected in 1930, the reorganization of the company and newly created and issued to themselves all of the new "Class A. stock,"

with its voting rights and raised $400,000. "In consideration of this contribution, the bondholders released stockholders' liability as to such contributors." [R. 76, 258.]

At the same time, they created and issued 5,112 shares of new "Class B. stock," "to such of the bondholders who accepted the same in payment of bond interest coupons." [R. 76.] Later "The Class B. stock in escrow was cancelled and thus the Class A. stockholders who contributed the $400,000 *came into control of the company.*" [R. p. 77.]

Then in control of the reorganized company in 1930 and released from their stockholders liability by all *depositing* bondholders, these same Class A. shareholders gave the money they contributed to the Shipbuilding & Dry Dock company and through it, tried to make money for themselves in the shipbuilding business and in the company which they now own.

These same stockholders made the last payment of interest on the bonds on February 1, 1929. That was the time when business prosperity was at its peak. This was several months *before* the stock market crash began on October 28, 1929. Apparently they could not, during the best business years, make enough money to satisfy themselves, or pay the interest as it became due on the bonds.

These are the same stockholders, with Daniel Murphy, multi-millionaire, dominating them, who started the corporation many years ago, and obtained $3,210,000.00 from the sale of the bonds in 1924, continued in business during subsequent years, and in 1930 effected their reorganization. By withholding interest on the bonds, these were,

of course, greatly depreciated in value. Then these present stockholders bought back, "as low as $65 per $1000 bond" [R. p. 254], the bonds for which they had received par. Always in control of the company and having on deposit from thoroughly discouraged bondholders, more than 75% of the total issue, they created a supplement to the trust deed in 1930, and sought to postpone foreclosure of the bonds until the year 1944. With that kind of experience behind them—a long record of failure to keep their obligations, these same substantial stockholders are deemed by the District Court to be alone worthy and competent to continue the business gamble at a time too, not as in those prosperous years of the past up to 1930, but NOW, at a time when there is a real depression existing. The Special Master and the District Court quite clearly indicate that they think the prospects are good of securing government contracts to build larger ships than the company is now equipped to handle. These same stockholders show that they have not enough confidence in business prospects for the future, to even promise to pay into the company any part of the "less than $500,000." which is now required to construct new "building ways," provide "for the removal of the dry-dock" and make the other necessary repairs which are described *in extenso* in the report of the special master and as adopted [R. p. 135] by the Court. [R. pp. 72, 73, 75, 76.]

These same wealthy stockholders who have handled the millions from the bond issue, indicate no desire to even personally provide the bonds which the Government always requires before it accepts bids for its work. Probably the only concern of these same stockholders is to acquire, free from the bonded lien, the valuable assets as their own, which the Plan would give to them.

Rather illuminating is it that no *creditors* other than the bondholders are "effected by said plan of reorganization." [R. pp. 16, 146.]

Present stockholders would greatly profit by the Plan, receive new stock in this insolvent corporation and own all assets free from the bonded lien.

Notwithstanding the past record of failure, the District Court gives as its reasons for awarding capital stock in the new corporation to present stockholders of an insolvent corporation, the following:

> "(22) The bonds of debtor are owned by approximately 757 individuals who are widely scattered and unorganized. It will be beneficial to the bondholders to allow the Class A shareholders to participate in this reorganization so as to provide continuity of management. [R. 321.]
>
> "(23) that it will be an asset of value to the New Company and its shareholders to retain Debtor's present Class A shareholders as shareholders of the New Company because of their familiarity with the operation of the business of Debtor and its subsidiary Shipbuilding Company, and because of their financial standing and influence in the community." [R. 321.]

These are the reasons of the District Court for confirming the plan and denying to bondholders their substantive rights.

We submit that even in cases where the first mortgage liens of bondholders are preserved and their right to fore-

close merely postponed, that the several decisions cited in this brief show that the District Court cannot consider possible future profits of a new corporation, a reason for denying to them, the rights of bondholders and forever taking their pledged property away from them.

We are of the belief that sound—and final—is the reasoning employed in the *Radford* case (Supreme Court), the *Horn* case, the *Tenn, Pub. Co.* case, the *Security-First Nat'l v. Rindge* case, where the Supreme Court on January 4th, 1937, denied certiorari,—all pronouncing the doctrine that

> "The right to retain a lien until the debt secured thereby is paid is a substantive property right which may not be taken from the creditor consistently with the Fifth and Fourteenth Amendments to the Constitution."

The claim of dissenting bondholders has been throughout, and is, that the Order Confirming the Plan violates their constitutional rights, and also violates the provisions of section 77B of the Bankruptcy Act in that this Plan is unfair and inequitable, and does not afford the "Adequate Protection" required by that section.

Under the law, petitioners seriously doubt whether any prospect of future profit, could furnish a basis for a District Court's judgment depriving dissenting bondholders of their lien and other substantive rights.

All of this reasoning of the learned trial Court could be made to apply, *as a matter of conjecture,* to *any* corpora-

tion which, like this Debtor, wanted to get rid of its bonded debt—and start anew. All corporations could plausibly argue:

1. That the old stockholders who have operated the business of a corporation, would be better fitted to continue the business than the bondholders who have had no such experience;

2. That because old stockholders in control of the corporation are wealthy, they might possibly be willing to advance money to carry on the new business concern;

3. That probably the chances of future profit are better with a new company which did not have to pay any of the interest due on a bonded debt, and especially so if, having cancelled the old bonded debt, they could raise additional or "new" money with the creation of a new bonded debt.

The Supreme Court of the United States contemplated something of this kind, in *Bank v. Florshem,* 290 U. S. 504, 79 L. Ed. 465, 474 & 475, when it decided:

> "By these means it was hoped to subject all dissenting creditors to the condition of impotency so frequently occupied by minority stockholders. * * * The purpose of the transaction was to hinder and delay certain creditors. * * *
>
> "The power of the District Court was invoked, not to enforce rights of creditors, but to defeat them. The fact that the means employed to effect the fraudulent conveyance was the judgment of a Court and not a voluntary transfer, does not remove the taint of illegality."

Conclusion.

Petitioners believe that the "Transcript of Record," furnished by the Circuit Court of Appeals to this Court, with the statement of evidence contained therein, shows the reasons why the District Court confirmed this plan. Until the Circuit Court of Appeals rendered its opinion deciding that its transcript was "partial and incomplete" and that "the appeal must be considered as one taken on the judgment roll alone," the transcript of record as furnished to the Circuit Court of Appeals, was complete and without criticism. The briefs of all counsel considered only the questions of law involved in this case. To have printed a *complete* transcript of the evidence with the many lengthy exhibits therein, would have supplied, unnecessarily, a tremendous record and would have cost several thousands of dollars. Appellants did not need such a transcript to present the questions of law and they, as well as Debtor corporation, did not want it.

There is not a word in that transcript to which Debtor consented in the Amended Praecipe requiring it. This was the exact transcript which the trial Court by its written order required to be printed, and there is nothing therein which can be considered, even remotely, as an attack upon the findings of fact found by the District Court. That Court's conclusions of law upon those facts furnish the basis for the claim of appellants that all of those facts together do not justify confirmation of this manifestly unfair plan.

Perhaps the opinion of the Circuit Court of Appeals that the appeal must be considered as one taken on the judgment roll alone, is the reason for its avoidance of the questions of substantive law presented by the Tran-

script of Record now before this Court and which were exhaustively presented and considered in the briefs of all counsel.

In a recent Supreme Court case, that of *In re 620 Church Street Building Corporation*, 299 U. S. 24, 27, 57 S. Ct. 88, 89, 81 L. Ed. 16, appears the following:

1. A judgment of the Circuit Court of Appeals declining jurisdiction of an appeal from an order of the District Court confirming a plan of reorganization under Section 77B of the Bankruptcy Act, held reviewable by *certiorari* under Section 262 of the Judicial Code, P. 26;

2. Section 262 Judicial Code permits the employment of the writ of *certiorari* in cases not covered by Section 240 and affords ample authority for using the writ as an auxiliary process and as a means of giving full force and effect to existing appellate authority and of furtherance of justice in other kindred ways.

The Circuit Court of Appeals in its opening statement asserts:

> "the record contains a statement of evidence and proceedings on the hearing of the proposed plan but *concededly* it is partial and incomplete."

APPELLANTS HAVE NEVER CONCEDED, OR THOUGHT, THAT IT WAS "INCOMPLETE." For all of the purposes of the appeal appellants considered, and petitioners do now consider, that the Transcript of Record is complete and that the record in this case and now before this Court, discloses the questions of law which furnish the basis for the appeal.

Just what the Circuit Court of Appeals meant by the use of the word "partial," is not clear to us. True it is

only a part of the evidence and it is "partial" to the conviction of petitioners that Section 77B does not contemplate or permit a consummation such as this, for any embarrassed corporation, or ever or at any time, under the circumstances of this case.

This "partial" statement of the evidence was the one *settled* by the District Court without objection from, and was settled with the consent of, counsel for Debtor Corporation. This was done as required by the Amended Praecipe in that Court. [R. 288, 289.] The District Court's order, in that respect, was made on July 6th, 1938, as shown by the Transcript of Record. [R. 263.]

The judgment roll alone, shows the character of this proceeding, the plan of reorganization, the findings of fact and the *conclusions of law* based upon those findings of fact and upon *them* arise the questions of law which seem to have been ignored by the Circuit Court of Appeals.

The appeal is based upon several important questions of substantive law shown by the record consisting of the judgment roll, the Transcript of Record before this Court containing the opinions and judgment of the District Court, a partial statement of the evidence, and the briefs of all counsel which were devoted exclusively to those questions of law which concern substantive rights.

The "stipulation" not to attack the findings of fact has been adhered to. The portion of the evidence stated in the transcript may not be necessary to this appeal on questions of law alone.

A certified copy of the order of the District Court requiring that this particular transcript containing part of the evidence, be printed as the transcript in the case, could

have been obtained and filed among the record of the Circuit Court of Appeals had any such question arisen.

This stipulation, signed by all counsel, narrates the *same six points* presented upon this appeal. [R. pp. 285-287.] There is nothing whatever in the stipulation not to question findings of fact, which requires any abandonment of any part of the record of the evidence *furnished in the transcript.* This transcript was specified in and required by the amended praecipe, as it appears in the Transcript of Record on pages 288, 289, which praecipe was adopted by all counsel and is not questioned in the briefs on appeal. It is a partial record of the evidence on both sides of the case and supports the substantive law relied upon in this case. Under our 6th specification of assigned errors relied upon, likewise the 6th "Point" *specified in this stipulation,* that "This plan is neither fair, equitable nor feasible and is discriminatory," petitioners have the right to comment on the record printed in the transcript. That is the order on file, made by the District Court, which directed the clerk to print that transcript as required by that amended praecipe, Appellants had the right and the duty to rely on the evidence printed by consent, in the transcript and to rely on the records in this case there printed.

To petitioners it seems repugnant to established legal principles to contemplate the cancellation of a first mortgage lien for an only consideration of 250 shares of $1.00 par value stock in a new corporation, for "each $1,000 bond, principal of the bond only," and where

nothing is allowed for the due and unpaid interest on the bonds, where 23 per cent of the new capital stock will be received by present stockholders of an admittedly insolvent corporation and where such present stockholders who are very large owners of deposited bonds (bought at 6½ cents on the dollar) will undoubtedly control the new corporation.

If the announced law of this case, up to the present time, is correct, *no* value hereafter can be placed on first mortgage bonds which, when a corporation refuses to pay them or to permit foreclosure, can be cancelled under 77B of the Bankruptcy Act, for a consideration in capital stock of a new corporation, estimated at only *one-eighth of the "face value of those bonds."*

The ultimate decision of this Court of last resort is of the utmost importance to the many corporations now in process of reorganization in the lower Federal Courts and to corporations which will attempt in the future to achieve the same result.

This solitary and unheard of example of corporate reorganization, as a victory which utterly destroys the bondholder, is being followed by members of the legal profession, the accounting professions, by the investment bankers and by the numerous bank trustees always named in bond issues. An enlightened philosophy concerning Section 77B should be the guiding influence in corporate reorganizations, for corporations in financial distress. That section was never intended as an instrument for the

perpetration of unfairness to secured creditors, or to any creditors.

Admittedly proposed for the solitary purpose of getting rid of the bonds, this plan of reorganization seems unconscionable. The present judgment in this case *as a precedent* for future corporate reorganization, will do immeasurable harm. Such a precedent, as a victory in high finance, if allowed to stand, will transmute a mortgage lien into shares of cheap capital stock. Such action will drive thousands of men and women of ordinary means—the usual type of purchasers of private corporation bonds—to want and starvation. A large number of corporations who desire to get rid of their bonds will seek, under this decision of the Circuit Court of Appeals, to perpetrate a similar fraud on their bondholders. A bond bought from a private corporation at 100 cents on the dollar, will no longer be a secured lien but a small number of shares of capital stock of a corporate cripple having very little, and probably no, value. When this new corporation is relieved of control by the Bankruptcy Court, there is nothing to prevent it from creating a new bond issue. Present stockholders bought at 6½ cents on the dollar [R. p. 254] *much* more than the "$676,500." owned by the "Security Company, wholly owned affiliate of the Trustee named in the trust indenture." [R. 84.] The foregoing and the fraudulent reorganization effected in 1930 when "all of the stock was wiped out by assessment," are revealed in the "partial" transcript of the evidence printed in this case.

The petition for Stay of Mandate and the Petition for Rehearing were denied by the Circuit Court of Appeals on February 9th, 1939.

It is respectfully submitted therefore that a Writ of Certiorari should be granted in this matter.

Dated: March 23rd, 1939, Los Angeles, California.

THOMAS K. CASE,
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APR 24 1939
CHARLES ELMORE CROPLEY
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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1938.

Nos. ~~817 and 818.~~ 23-24

IN THE MATTER OF
LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.,
a corporation,

Debtor.

THOMAS K. CASE AND ADELE B. COWAN,

Petitioners,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.,
a corporation,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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I.

Grounds for denial of petition 5

1. Petition herein should be denied for the reason that it does not contain (a) a summary and short statement of the matter involved, or (b) a statement particularly disclosing the basis upon which it is contended that this court has jurisdiction to review the judgment or decree in question, or (c) the questions presented, or (d) the reasons relied on for the allowance of the writ. The supporting brief annexed to the petition is neither direct nor concise 5

2. If it granted the writ, this court could reach no different decision than the Circuit Court, due to the absence of a complete record and the stipulation of the petitioners not to question the findings of the District Court 6

3. None of the reasons as outlined in paragraph (5b) of rule 38 of this court has been or can properly be argued as a ground for the granting of the writ in this case 8

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1938.

Nos. 817 and 818.

IN THE MATTER OF

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,

Debtor.

THOMAS K. CASE AND ADELE B. COWAN,

Petitioners,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

To the Honorable Charles Evans Hughes, Chief Justice, and to the Honorable Associate Justices of the Supreme Court of the United States:

Statement of Case.

Petitioners herein seek a writ of certiorari to review the decision [R. pp. 372-380] of the United States Circuit Court of Appeals, for the Ninth Circuit, made on January 12, 1939, in the above mentioned cause, said decision being reported in Volume 100 Fed. (2d) at page 963. Said decision of the said Circuit Court was rendered

on appeals from the interlocutory order [R. pp. 129-155] and final order [R. pp. 306-364] made by the Honorable Ralph E. Jenney, Judge of the District Court of the United States, Southern District of California, Central Division, In the Matter of Los Angeles Lumber Products Company, Ltd., debtor, confirming the plan of reorganization [R. pp. 18-41] and modifications thereto [R. pp. 58-62] (herein referred to as the "plan") proposed by Los Angeles Lumber Products Company, Ltd. (sometimes referred to in the petition and in petitioners' brief as debtor or debtor corporation, but hereinafter referred to as "respondent") in the above mentioned proceeding filed under and pursuant to the provisions of Section 77B of the National Bankruptcy Act. The decision of the District Court and its opinion in connection therewith is reported in Volume 24 Fed. Supp. at page 501.

The two appeals above mentioned were consolidated by stipulation of counsel and order of the Circuit Court [R. pp. 365-368]. A complete and concise statement of the facts of this case is to be found in Appendix I to this brief, in the opinions of the District Court [R. pp. 202 to 245] and of the Circuit Court [R. pp. 372 to 380] and also in the report of the Special Master [R. pp. 63 to 118]. So as not to unduly lengthen this brief, we refer to said Appendix and said portions of the record for a statement of facts and incorporate the same herein by reference if this Court deems the consideration of the facts of the case essential to a determination of the question of whether a writ should or should not be granted. In answering petitioners' arguments respondent has, in certain instances, referred to the facts of the case at bar, but we have not undertaken to point out or correct all of the inaccuracies or omissions in factual statements made by petitioners.

SUMMARY OF ARGUMENT AS REQUESTED BY PARAGRAPH 2(f) OF RULE 27.

I.

Grounds for Denial of Petition.

Respondent submits that the petition herein should be denied for the following reasons:

1. The petition does not contain (a) a summary and short statement of the matter involved, or (b) a statement particularly disclosing the basis upon which it is contended that this Court has jurisdiction to review the judgment or decree in question, or (c) the questions presented, or (d) the reasons relied on for the allowance of the writ. The supporting brief annexed to the petition is neither direct nor concise.

2. If it granted the writ, this Court could reach no different decision than the Circuit Court, due to the absence of a complete record and the stipulation of the petitioners not to question the findings of the District Court.

3. None of the reasons as outlined in paragraph 5(b) of Rule 38 of this Court has been or can properly be urged as a ground for the granting of the writ in this case.

II.

Respondent's Answers to Petitioners' Arguments.

Petitioners' arguments, in the main, go to the conclusions reached by the District Court on the merits of the case, as to substantially all of which the Circuit Court ruled that it was bound by the judgment of the District Court. As to the remaining points the Circuit Court affirmed the District Court's decision. Accordingly, petitioners' arguments are not appropriate in this proceeding;

nevertheless, respondent has briefly answered all the main contentions of petitioners herein and a brief summary thereof is as follows:

As to Points I, V and VI (which go to the merits and attack the findings and conclusions of the District Court), if it granted the writ, this Court could reach no different decision than the Circuit Court, due to the absence of a complete record and the stipulation of the petitioners not to question the findings of the District Court.

As to Point II, the question of respondent's solvency is immaterial, since the present shareholders' participation in the reorganization is based upon the fact that they are contributing a new, additional, and valuable consideration to the reorganized company, the value of which the District Court found exceeded the value of the new stock being issued to the present shareholders of respondent under the plan.

As to Point III, the provisions of Subdivision (b)(5) of Section 77B have no relevancy to the case at bar, since the holders of more than two-thirds in amount of the bonds in this case consented to the plan.

As to Point IV, petitioners' premise is wrong, for they fail to take cognizance of the fact that bankruptcy has intervened, that the plan has been found fair, equitable, feasible and not discriminatory by the District Court and that the holders of more than two-thirds in amount of the bonds in this case have consented thereto.

As to Point VII, to hold respondent estopped by the quoted provision of the trust indenture would be to enforce a contract not to take advantage of the provisions of the bankruptcy law, which contract would be unenforceable. This provision of the indenture was, and could properly be, disregarded by the District Court under the provisions of Subdivision (b)(10) of Section 77B.

I.

Grounds for Denial of Petition.

1. PETITION HEREIN SHOULD BE DENIED FOR THE REASON THAT IT DOES NOT CONTAIN (A) A SUMMARY AND SHORT STATEMENT OF THE MATTER INVOLVED, OR (B) A STATEMENT PARTICULARLY DISCLOSING THE BASIS UPON WHICH IT IS CONTENDED THAT THIS COURT HAS JURISDICTION TO REVIEW THE JUDGMENT OR DECREE IN QUESTION, OR (C) THE QUESTIONS PRESENTED, OR (D) THE REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT. THE SUPPORTING BRIEF ANNEXED TO THE PETITION IS NEITHER DIRECT NOR CONCISE.

Respondent's position stated in the summary is either well taken and should be accepted by this Court, or rejected. It does not need extended argument.

The rules of this Court on the subject of certiorari have been clear and explicit for many years, and the revisions adopted February 13, 1939, which became effective February 27, 1939, are even more explicit. Rule 38 provides, in paragraph 2 thereof, that a failure to comply with the requirements of the rule will be a sufficient reason for denying the petition. In paragraph 5 of Rule 38 this Court has stated very clearly that a review on a writ of certiorari is not a matter of right, but a matter for sound judicial discretion and will be granted only where there are special and important reasons therefor, and the rule points out certain types of reasons which will be considered by the Court. The failure of petitioners, in their sixteen-page petition, to advance any sound reasons for the granting of the writ and particularly any reasons of the character outlined in Rule 38, paragraph 5, is pointed out later in this brief.

Petitioners' brief is neither direct nor concise. It is approximately sixty pages in length and is a co-mixture of an argument with respect to the merits of the plan of reorganization and the decisions of the District and Circuit Courts with respect thereto, the facts which were presented to and considered by the District Court, and certain propositions of law, which petitioners refer to repeatedly as "questions of substantive law". Respondent submits that all questions of law in this case were correctly decided by the District Court and the Circuit Court, and that no review is necessary or possible in the state of the record.

2. If it Granted the Writ, This Court Could Reach No Different Decision Than the Circuit Court, Due to the Absence of a Complete Record and the Stipulation of the Petitioners Not to Question the Findings of the District Court.

This Court will note that petitioners were before the Circuit Court on the judgment roll and with only a partial transcript of the record in the case. Respondent did not insist upon a complete record because of a stipulation between counsel for petitioners and respondent, by the terms of which, among other things, petitioners agreed that on their appeal to the Circuit Court they would raise questions of substantive law only and that they would not question the regularity of any procedure had in the District Court and would not attack any finding of the Dis-

trict Court on the ground that it was unsupported by the evidence [R. pp. 285-287].

The Circuit Court, in its decision [R. pp. 372-380], held that, because of the state of the record and in the light of said stipulation, it was not possible for it to do other than accept and affirm the orders of the District Court. It is submitted by respondent that if this Court granted the writ of certiorari and reviewed the said decision of the Circuit Court, it could reach no other or different decision than was reached by said Circuit Court. The District Court made certain findings of fact upon which it based certain conclusions of law which were in accord with the clear and undisputed provisions of Section 77B. The Circuit Court upheld the District Court in the conclusions of law which were reached by the District Court. The Circuit Court also held that, due to the condition of the record on appeal and the stipulation between petitioners and respondent, the Circuit Court could not go behind the findings of fact made by the District Court and weigh the evidence upon which the District Court based said findings. As pointed out above, if this Court undertook to review this case, it would find itself in no different position than the Circuit Court found itself. Respondent respectfully submits that this conclusion can be reached by this Court by a mere reading of said stipulation [R. pp. 285-287] and the opinion of the Circuit Court [R. pp. 372-380].

3. NONE OF THE REASONS AS OUTLINED IN PARAGRAPH 5(B) OF RULE 38 OF THIS COURT HAS BEEN OR CAN PROPERLY BE ARGUED AS A GROUND FOR THE GRANTING OF THE WRIT IN THIS CASE.

Respondent has called to the attention of this Court, under paragraph 1 above, that Petitioners have failed to give any reasons upon which they relied for the allowance of the writ. The Circuit Court has not rendered a decision in conflict with the decision of any other Circuit Court of Appeals on the same matter. It has not decided an important question of local law in conflict with applicable local decisions. It has not decided a federal question in a way probably in conflict with applicable decisions of this Court, nor has it so far departed from the accepted and usual course of judicial proceedings or so far sanctioned such a departure by the District Court as to call for an exercise of this Court's power of supervision.

It therefore remains, under this point, for respondent to briefly discuss the question of whether the Circuit Court has decided an important question of federal law which has not been, but should be settled by this Court. Respondent submits that the only questions of law decided by the Circuit Court are (a) that it, in the condition of the record and in the face of the stipulation, could not go behind the findings of fact made by the District Court, (b) that it could not say as a matter of law that the extent to which the shareholders were permitted to participate was too great or that the compromise by present shareholders of their rights was not of substantial value to

those holding the bonds, (c) that the provisions of Subdivision (b)(5) of Section 77B have no relevancy to this case, since they are applicable only where the holders of less than two-thirds in amount of a given class of creditors have accepted the plan, and in this case the holders of more than two-thirds in amount of the bonds have consented to the plan, (d) that Section 77B clearly empowers the Court to approve a proposal altering the rights of secured creditors either through the issuance of new securities of any character, or otherwise, and that a plan substituting preferred stock for secured bonds is within the purview of the Act, and (e) that if (as in the case at bar) the proposal is found to be fair and feasible and not discriminatory in favor of any class, the consent of two-thirds of a class is binding on the minority, notwithstanding their rights are materially altered. The conclusions of the Circuit Court on these elementary principles of interpretation of Section 77B are all in accord, not only with all of the decisions of this Court, but also with all of the decisions of the various Circuit Courts and District Courts which have been handed down and are available in the published reports since the enactment of Section 77B.

Petitioners have argued in their brief that the plan proposed by respondent and confirmed by the District Court in this case is a solitary and unheard-of example of corporate reorganization and is a victory which utterly destroys the bondholder. Petitioners are concerned that this case, if allowed to stand, will be a precedent for the transmutation of a mortgage lien into cheap capital stock

and that such action will drive thousands of men and women of ordinary means to want and starvation. Respondent submits that it is clearly contemplated by Section 77B, and all of the decisions so hold, that dissenting secured creditors may be forced to take shares of stock to evidence their proportionate interest in a reorganized corporation provided (1) the holders of two-thirds in amount of the secured claims in the class consent to such "transmutation" and (2) the Court finds the plan to be fair, equitable, feasible and non-discriminatory. As pointed out in the able decision of the District Court [R. pp. 202-245] such a statutory provision is constitutional and when the constitutional question is properly presented to this Court, respondent submits, as did the District Court, that this Court will so hold. Petitioners argued the constitutionality vigorously before the District Court, but expressly did not question the constitutionality in their appeal to the Circuit Court [R. p. 380] and have not raised any constitutional question in their petition to this Court, although in their brief (Br. p. 71) they urge that the order confirming the plan violates their constitutional rights and also violates the provisions of Section 77B of the Bankruptcy Act in that the Plan is unfair, inequitable and does not afford the "adequate protection" required by that section. We will not lengthen this brief by a duplication of a citation of authorities and a discussion on this subject, which has been well covered by the District Court in its decision [R. pp. 202-245].

II.

Respondent's Answers to Petitioners' Arguments.

Petitioners have set forth in their brief extended arguments which attack the conclusions of the District Court on the merits of the plan in this case. Although respondent is of the opinion that the petition should be denied for the reasons set forth above and that the arguments of petitioners on the merits are not appropriate in this proceeding, nevertheless respondent will briefly answer said arguments (in the order presented by petitioners); so that respondent's views will be clear to this Court if it desires to consider them.

(1) Answer to Petitioners' Point I.

The District Court, based upon a careful consideration of all of the facts and the plan, found that the plan was fair, equitable, feasible, not discriminatory, and confirmed the same [R. pp. 306, 328 and 340]. The Circuit Court affirmed the District Court's decision, stating that in the state of the record and in the light of the stipulation hereinbefore referred to, it was not possible for it (the Circuit Court) to do other than accept these findings [R. pp. 376-377].

Petitioners argue:

> "This Plan Takes Away From Petitioners Their Vested Rights in the Properties Mortgaged by Debtor to Secure Payment of the Bonds, Without Payment in Full, Without Payment of Any Due and Unpaid Interest on the Bonds and, Only for 'the Principal

Amount of the Bonds', Offers Preferred Stock in a New Corporation on an Unfair and Inadequate Basis." (Br. p. 23.)

Subdivision (e)(1) of Section 77B provides

"a plan of reorganization shall not be confirmed until it has been accepted in writing * * * by or on behalf of creditors holding two-thirds in amount of the claims of each class whose claims have been allowed and would be affected by the plan * * *."

This section, together with other provisions of Section 77B, as interpreted by court decisions, gives authority for the scaling down of a secured debt by way of reduction of interest, reduction of principal, extension of maturity date, or the substitution of shares of stock for securities evidencing a secured debt, provided two-thirds in amount of the class have consented, and provided further that the plan is determined by the District Court to be fair, equitable, feasible and not discriminatory as to any member of the particular class. Here it is admitted that the plan submitted has been consented to by the holders of over 90% in principal amount of respondent's bonds [R. pp. 210, 327]. The District Court has found the plan to be fair, equitable, feasible and not discriminatory [R. pp. 306, 328, 340]. Petitioners, by their stipulation, are bound not to attack these findings of fact and the proceedings of the District Court [R. p. 285; Br. p. 75]. The Circuit Court affirmed the District Court's decision, stating that, in the state of the record and in the light of the stipulation, it was not possible for it (the

Circuit Court) to do other than accept these findings [R. pp. 376-377].

The cases cited by petitioners in support of their argument can be readily distinguished. In *Louisville Joint Stock Company v. Radford,* 290 U. S. 555, the Supreme Court did make the statement quoted, but a reading of the case indicates that it has no bearing upon and is not analogous to the case at bar. It arose under the first Frazier-Lemke Act, which is Section 75s of the Bankruptcy Act. It dealt with a single mortgagee and not with a group or class of secured creditors. For further discussion we respectfully refer the Court to that portion of the District Court's learned opinion in this case wherein the *Radford* case is discussed [R. pp. 213-214].

In *Security-First National Bank v. Rindge Land Company,* 85 Fed. (2d) 557, the Circuit Court of Appeals for the Ninth Circuit held as indicated by petitioners in their brief, but this case is not authority for the proposition submitted by petitioners. In the *Rindge* case the plan of reorganization contemplated the sale of property subject to the lien of the bonds for sufficient to pay the bondholders 40¢ on the dollar. The bondholders in question owned 98% in principal amount of the oustanding bonds and *refused to consent to the plan.* The only issue before the Circuit Court was whether one who had purchased bonds at 40¢ on the dollar of their face value could be forced, under a reorganization proceeding under Section 77B instituted by the obligor on the bonds, to accept in full settlement 40¢ on the dollar, which was the amount which said purchaser had paid for the bonds. The Court

disapproved the plan. The case is not in any way analogous to the case at bar for the reasons set forth.

In the case of *In re Day & Meyer, Murray & Young*, 93 Fed. (2d) 657, 35 A. B. R. N. S. 440 (C. C. A. 2, 1938), cited by petitioners, the appealing bondholders owned a small portion of the outstanding first mortgage bonds. The total amount of such bonds outstanding was $590,500 and, in addition, unpaid interest in an approximate amount of $173,000. All of the assets, with the exception of certain current assets in cash, were subject to the mortgage which secured the bonds and the value of the mortgaged assets exceeded the principal of the bonds. Under the plan of reorganization before the Court the first mortgage bonds would have been reduced to 50% of their principal amount. The equity thereby created was to have been represented by new preferred stock (which was to be shared dollar for dollar by the bondholders with the general creditors) and new common stock which was to be shared by bondholders with the preferred stockholders and general creditors. The old common stockholders were to be eliminated entirely. The Court found that the company was insolvent and that there was no justification for reducing the bonds to one-half the principal amount and for eliminating the total of unpaid interest, and thus giving that equity to the old general creditors and stockholders, where no new consideration was given by the stockholders. This appears from the following quotation from page 659 of the decision in said case as reported in 93 Fed. (2d) 657:

> "The total liabilities of the corporation exceed the assets by $84,000. There is therefore no equity for either the preferred or common stock and, *without contributing a new consideration*, the preferred stockholders should not receive new common stock share

for share. This is the same class of preferred stock which goes to the first mortgage bondholders for their substantial interest claim." (Italics ours.)

In re Day & Meyer, Murray & Young, 93 Fed. (2d) 657 at 659.

In the case at bar the District Court found [R. pp. 321-323] that the present shareholders were properly permitted to participate in the plan and receive shares of stock in the reorganized company because (1) the value to the bondholders of maintaining the debtor as a going concern and of avoiding litigation is in excess of the value of the stock being issued to the present shareholders and (2) valuable consideration is given for such participation in the virtual abrogation of the 1930 amendment deferring foreclosure until 1944 and (3) the continued participation of the present shareholders in the reorganized company will be an asset of value to it because of the familiarity of these stockholders with the business of the reorganized company and because of their financial standing and influence in the community.

Respondent does not deem it helpful or necessary to discuss the *Continental Illinois National Bank v. Chicago Rock Island*, 294 U. S. 648, and *Northern Pacific Railway Company v. Boyd*, 228 U. S. 482, cases cited by petitioners, as they clearly have no bearing on the case at bar.

In re Tennessee Publishing Company, 299 U. S. 18, has been cited at several points in petitioners' brief, and we will not lengthen this brief by a discussion of that case and its disposition in the courts, as it does not support petitioners' contention. We would, however, respectfully call the attention of this Court to such a discussion, which appears in the decision of the District Court in this case [R. pp. 211-212].

(2) Answer to Petitioners' Point II.

At pages 27 to 32, both inclusive, of their brief petitioners cite a large number of cases to the effect that where a corporation is insolvent there remains no equity in which the stockholders may claim a participation. We have no quarrel with the cases cited and, hence, refrain from discussing them.

A complete answer to petitioners' criticism of allowing the present shareholders to participate in the Plan in the case at bar lies in the fact that such participation is not based upon any so-called equity, but upon the fact that said present shareholders are contributing a valuable new and additional consideration to the reorganized company.

The District Court found, after a careful consideration of all of the evidence and the plan, that the value to the bondholders of maintaining the debtor (respondent herein) as a going concern and of avoiding litigation was in excess of the value of the stock of the reorganized company being issued to the present shareholders of respondent under said plan [R. p. 323]; that the principal valuable consideration passing between the bondholders and the present shareholders to justify their participation in the plan is the virtual abrogation of the 1930 amendment deferring foreclosure of the bonds until 1944 [R. pp. 321-322]; that the continued participation of the present shareholders in the reorganized company as shareholders would be an asset of value to it and its other shareholders (the old bondholders) because of the familiarity of the present shareholders with the business and because of their financial standing and influence in the community [R. p. 321]; that the reorganization places the bondholders in a position where they, as shareholders, may exercise control of the reorganized company [R. p. 233],

whereas if it were not for the reorganization, the present shareholders would retain control until the maturity of said bonds in 1944 [R. pp. 220-230, 320]. The Circuit Court held that the findings of the District Court and the said stipulation foreclosed any inquiry by the Circuit Court on these points and that the Circuit Court could not find, as a matter of law, that the extent to which the present shareholders were permitted to participate was too great or that a compromise of their rights was not of substantial value to those holding the bonds [R. p. 378].

Inasmuch as none of the decisions cited by petitioners in any way conflicts with the foregoing rule, and since the able opinion of the District Court discloses ample authority in support of the same [R. pp. 225-228], respondent believes that it is unnecessary to further lengthen this brief by the citation or discussion of such authorities.

(3) Answer to Petitioners' Point III.

The District Court [R. p. 231] decided, as did the Circuit Court [R. pp. 378 and 379], that the provisions of subdivision (b)(5) of Section 77B were not applicable, since that subdivision covers only cases where less than two-thirds in amount of a given class have accepted the plan. Here the holders of more than two-thirds in amount of the bonds approved the plan [R. p. 327].

Petitioners state (Br. p. 33) that the first part of their point, to-wit, that the plan is not fair because no compensation is provided for dissenting bondholders for the loss of their mortgage lien, seems to have escaped determination by the Circuit Court. The Circuit Court [R. pp. 379 and 380] clearly held that a plan substituting preferred stock for secured bonds is within the purview of

Section 77B of the Bankruptcy Act and that if the proposal is found to be fair, feasible and not discriminatory in favor of any class, the consent of two-thirds of a class is binding on the minority, notwithstanding the fact that their rights are materially altered.

Petitioners also state (Br., p. 33) that the Circuit Court decided that the plan did afford "adequate protection" as contemplated in subdivision (b)(5) of Section 77B of the Bankruptcy Act. We respectfully call this Court's attention to the decision of the Circuit Court [R. pp. 378 and 379] where the Circuit Court held that the provisions of subdivision (b)(5), just referred to, have no relevancy to the case at bar since they are applicable only where less than two-thirds in amount of a given class have accepted a plan and that in this case the holders of more than two-thirds in amount of the bonds have approved the plan. Respondents believe that none of the cases cited in petitioners' argument on this point has any bearing on this case in the light of the fact that the holders of more than two-thirds in amount of the bonds consented to the plan and the plan was found to be fair, feasible and not discriminatory.

(4) Answer to Petitioners' Point IV.

The District Court [R. pp. 218-220] and the Circuit Court [R. pp. 379 and 380] held that Section 77B clearly empowers the Court to approve a plan consented to by the holders of the requisite percentage in amount of secured bonds and substituting preferred stock for secured bonds if the proposal is found to be fair and feasible and not discriminatory in favor of any class, and that such plan and consent is binding on the non-consenting minority

bondholders, notwithstanding the fact that their rights are materially altered under such a plan.

The cases cited by petitioners simply hold that where a plan is found by the Court to be unfair, not feasible or discriminatory the same cannot be sustained even if a large majority of the creditors has approved the plan. This rule clearly has no applicability to the case at bar, for the reason that the District Court found the plan to be fair, equitable, feasible and not discriminatory. [R. pp. 306, 328 and 340.] Petitioners, by their stipulation, are bound by this finding and the cases cited, therefore, have no bearing on the case at bar.

(5) Answer to Petitioners' Point V.

Under this point petitioners argue that respondent in formulating the plan has excluded interest unpaid on the bonds. (Op. Br. p. 44.) Under the plan approximately 77% of the shares of stock of the reorganized company go to the bondholders and 23% to the present shareholders. This basis of distribution was arrived at by agreement in connection with the formulation of the plan and was approved by the District Court. The face value of the bonds outstanding is used merely as a basis for computing the number of shares of stock to go to each bondholder and it makes no difference that the interest unpaid on the bonds was excluded in this arithmetical computation. The 250 shares to which each bondholder is entitled because of his ownership of $1,000 principal amount of bonds would be exactly the same if the basis of computation used in making the distribution among the bondholders was the total of principal and unpaid interest on each bond.

(6) Answer to Petitioners' Point VI.

In answering petitioners' argument made under this point, respondent can do nothing more than call this Court's attention to the finding of the District Court that the plan is fair, equitable, feasible and not discriminatory. [R. pp. 232-233, 306, 328, 340.] By the stipulation [R. pp. 285-287] petitioners agreed that they would not attack any findings of the District Court on the ground that they are unsupported by the evidence.

Under the plan, petitioners, as bondholders, are treated the same as all other bondholders. Petitioners apparently believe they should have been in some way preferred over other bondholders. Such a disposition of dissenting bondholders in itself would create a discrimination. The District Court [R. pp. 242-243] very aptly described the position of petitioners in this proceeding as follows:

> "The court is familiar with the usual proposals in these cases—to pay off in full the non-assenting, or at least the objecting, bondholders and get rid of them. It does not approve of any such proposal. It sees no reason why any portion of the money available for bondholders should be diverted to pay off any particular bondholders. Every one here will, I believe, agree with that principle. It is, of course, true that a court of equity will not allow minority bondholders to be disregarded, or unfairly treated in a reorganization plan, yet, on the other hand, it will not lend its aid to a claim by a minority bondholder which may result in holding up a fair reorganization plan, solely as a means of obtaining greater value or more favorable returns for that minority bondholder than are offered to all the other bondholders.

"I want it definitely understood that this court does not believe that Mr. Case and the other objector are in here with the deliberate idea of holding up this proceeding, in order to shake down the rest of you, and compel you to pay them off. In fact, I would state, from my knowledge of men, that this is not the case. However, it is unfortunate that the effect is just exactly the same as though they were doing that very thing. That is, the legal effect of it is exactly the same, and this court believes that it was to avoid just such abuses that Section 77-B was placed on the statute books by Congress." [R. pp. 242-243.]

(7) Answer to Petitioners' Point VII.

Petitioners urge an estoppel. This argument was completely answered by the District Court in its decision. [R. pp. 234-235.] We adopt the position taken by the District Court as a complete answer but if this Court is interested, its attention is respectfully called to that portion of the record referred to above and to the cases cited. To hold that respondent is estopped by the covenant of the trust indenture referred to by petitioners would be to enforce a contract not to take advantage of the provisions of the bankruptcy law. Such contracts have been universally held unenforceable. Furthermore the District Court had authority to, and did properly, disregard this provision of the trust indenture under the provisions of subdivision (b)(10) of Section 77B, which provides:

"* * * the judge shall scrutinize and may disregard any limitations or provisions of any depositary agreements, trust indentures, committee or other authorizations affecting any creditor under this section * * *."

III.

Conclusion.

Respondent respectfully submits that for all of the foregoing reasons the petition for writ of certiorari should be denied.

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APPENDIX.

Statement of Facts.

Respondent is a holding corporation owning and holding all of the capital stock, except qualifying shares, of six subsidiary corporations. Three of these subsidiaries are without assets and are ready for dissolution. Of the other three corporations, two have assets of little value which are to be sold as soon as possible, the proceeds therefrom to be divided among the bondholders and a dissolution of the corporations effected. The only subsidiary having substantial assets is Los Angeles Shipbuilding & Drydock Corporation (hereinafter referred to as "Shipbuilding Company") [R. pp. 67-69, 313-315]. This subsidiary is engaged in building and repairing ships in its shipyards located on approximately 68 acres of tidelands leased from the City of Los Angeles at Los Angeles Harbor. Its main assets consist of a ship repair and shipbuilding plant and cash on hand. Its present operating activities consist chiefly in the repairing of merchant vessels, although it was originally organized during the World War to carry on an extensive program of ship construction. During its busiest years the corporation employed several thousand men each day and did a gross volume of business running into many millions of dollars [R. pp. 70-74, 313-315]. In 1924 respondent issued and sold approximately three and one-half million dollars principal amount of its First Lien and Collateral Trust 20 Year 7½% Sinking Fund Gold Bonds. This bond issue was secured by a pledge under a mortgage

or trust indenture of all the shares of capital stock, except directors' qualifying shares, of all of respondent's subsidiary corporations, which mortgage or trust indenture also covered respondent's fixed assets and the fixed assets belonging to respondent's subsidiary corporations. There are presently outstanding of this bond issue $2,565,500 face value of bonds upon which no interest has been paid since February 1, 1929 [R. pp. 204, 319, 326].

In 1930 respondent became financially embarrassed and a voluntary reorganization was effected through the medium of a Bondholders' Protective Committee. Under the arrangement consummated at that time holders of 97% of the outstanding bonds filed their written consents with the Bondholders' Protective Committee authorizing and directing the execution of a supplemental and amended trust indenture. The original trust indenture, above referred to as a mortgage or trust indenture, securing the payment of said bonds, and particularly Section 11, Article IX thereof, provided that the bonds and the trust indenture might be amended by a supplemental indenture executed by respondent, its principal subsidiary, the Los Angeles Shipbuilding & Drydock Corporation, and the trustees under said indenture, with the consent of the owners or holders of at least 75% in principal amount of the bonds outstanding or with the consent of the bond underwriters and the owners and holders of at least a majority in principal amount of the bonds outstanding provided, however, that no amendment of the bonds or trust indenture could be made which might create any discrimination among or

between outstanding bonds. Acting pursuant to the consents of the holders of 97% in principal amount of the outstanding bonds and the power so given in the trust indenture, a supplemental and amended trust indenture was duly executed, by the terms of which, among other things, the interest rate of the bonds was reduced from 7½% to 6% and the right to foreclose under the trust indenture for failure to pay interest unless the same was earned was waived until 1944, the maturity date of the bonds [R. pp. 204-205; 321].

Under this arrangement consenting bondholders waived any right to enforce the statutory California stockholders' liability against the stockholders holding a large proportion of the outstanding capital stock, which stockholders, in consideration of the amendments to the trust indenture, and as a part of the arrangement contributed $400,000 cash to the capital of respondent. The bondholders who consented to this arrangement deposited their bonds with a trustee under a Declaration of Trust and received certificates of deposit therefor. The articles of incorporation of respondent were also amended to provide for Class A and Class B shares without par value which were issued in conformity with the terms of the permit from the Division of Corporations of the State of California [R. pp. 204-205; 320].

There are now outstanding 57,788 shares of Class A stock and 5,112 shares of Class B stock of respondent [R. pp. 205 and 319].

In 1937 another voluntary reorganization was attempted under a plan which the Division of Corporations of the State of California, after public hearing, deemed to be fair and equitable. It was proposed that this 1937 plan be consummated by one of two methods, either (1) by consent of the parties, or (2) a Bankruptcy Act Section 77B proceeding; and that the method to be followed would be determined by the Board of Directors of respondent. The second method was finally adopted by the Board owing to its inability to obtain sufficient consents without court action to the first method [R. pp. 80, 313-315]. Financial difficulties had arisen largely because respondent and its principal subsidiary, the Shipbuilding Company, were unable to secure credit, due to respondent's top heavy bond issue, nor were they able because of the prior lien of the bond issue to secure faithful performance bonds from the surety companies, which were essential to the undertaking of any shipbuilding contracts. All of the fixed assets of the Shipbuilding Company were appraised by the American Appraisal Company at $465,000. These assets were directly subject to the bond issue. The other assets of the Shipbuilding Company, including cash, accounts receivable, inventory, supplies, etc., in 1937 were estimated at approximately $365,203.03. These last mentioned assets were not directly subject to the lien of the trust indenture securing respondent's bonds, but the capital stock of the Shipbuilding Company, as well as that of the other subsidiary companies, was held by the trustee as hereinbefore indicated as additional security for the bonds. The result of the appraisal showed that the assets of respondent and its principal subsidiary had a value of approximately $830,000 [R. pp. 80, 205-206, 313-316].

In connection in January, 1938, with the filing of the petition by respondent as debtor in the proceeding entitled, "In the Matter of Los Angeles Lumber Products Company, Ltd., a corporation, Debtor, in proceedings for the reorganization of a corporation," in the District Court of the United States for the Southern District of California, Central Division, Cause No. 31352 RJ on the docket of said court, respondent herein proposed a plan of reorganization which was similar in all respects to that theretofore approved in 1937 by the Division of Corporations of the State of California. The plan, briefly stated, contemplated the formation of a new corporation to be known as Los Angeles Shipbuilding & Drydock Corporation, which corporation was to acquire, free and clear of liens, the assets of respondent and its principal subsidiary, the Shipbuilding Company, except the capital stock of Masset Timber Company, Ltd., and Puget Sound Lumber & Box Company, two of respondent's subsidiaries which were to be liquidated and the proceeds derived from liquidation distributed pro rata among the bondholders as stated above. The new corporation was, according to the plan, to have an authorized stock of 1,000,000 shares of the par value of $1.00 per share, 830,000 shares were to be presently issued as follows: 590,065 shares to the holders of outstanding bonds pro rata on the basis of 230 shares for each $1000 bond and 239,935 shares to the holders of the Class A stock of respondent who had in 1930 contributed $400,000, as stated above, and who were largely responsible for the management of respondent. The balance of the authorized capital stock, 170,000 shares, was to be retained in the treasury for future sale in the event additional working capital was needed. Thereupon respondent and

all remaining subsidiaries were to be liquidated and dissolved. By the terms of the proposed Plan of Reorganization the capital stock of the new corporation was made non-assessable and the Board of Directors was to continue as theretofore until the new stockholders elected their successors. All creditors of respondent, other than bondholders and respondent's subsidiaries, and all expenses of administration were to be paid in cash. Under the proposed plan bondholders were to receive approximately 71% of the capital stock of the new corporation and the said Class A shareholders of the respondent were to receive approximately 29% thereof. Class B stockholders, practically all of whom were also bondholders, were to receive nothing. The original plan was duly accepted by the holders of over 90% in principal amount of the outstanding bonds, over 99% in amount of outstanding Class A stock and over 89% in amount of Class B stock [R. pp. 18-41, 206-207].

During the hearings before the Special Master herein the Plan of Reorganization as originally proposed was amended so that bondholders are now to receive approximately 77% of the capital stock of the new corporation presently to be issued instead of 71% as originally planned and so that the old Class A stockholders will receive 23% instead of 29%, and the capital stock of the new corporation is to be divided into preferred and common stock, all shares of both classes having equal voting rights per share, but the preferred stock having preference upon liquidation to the extent of the par value thereof over the common stock, and having preference as to non-cumulative dividends in any year to a payment up to 5% before any amount shall be paid on common stock. Thereafter dividends to be paid on the same basis to both preferred and

common stock. Under this amended plan the shares of stock to be issued to bondholders are all to be preferred stock. 830,000 shares of the authorized capital of 1,000,000 shares at $1.00 par value are to be issued as follows: 641,375 shares of preferred stock to bondholders pro rata on the basis of 250 shares for each $1,000 bond and 188,625 shares of common stock to the holders of Class A stock of the debtor corporation. The balance of the authorized capital shares amounting to 170,000 shares of preferred stock will be retained in the treasury for future sale in the event additional working capital is needed [R. pp. 58-62, 209-210]. The amended plan has been properly approved in writing by the owners and holders of 92.81% face value of respondent's outstanding bonds; 99.75% of respondent's Class A capital stock; and 90% of respondent's outstanding Class B capital stock [R. pp. 210 and 327; N. B.: The discrepancy between the final order, R. p. 327, and the opinion of the District Court, R. p. 210, is due to the fact that adidtional consents came in after the execution of the final order and prior to the rendition of the opinion].

No objection has been made to the approval of the plan by any stockholders or creditors of respondent, except petitioners herein, who are the owners and holders of $18,500 face value of respondent's outstanding bonds [R. p. 210].

OCT 9 1939
CHARLES ELMORE CROPLEY
CLERK

IN THE

SUPREME COURT
OF THE
UNITED STATES.

OCTOBER TERM, 1939.
Nos. 23 and 24.

In the Matter of
LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.,
a corporation,

Debtor.

THOMAS K. CASE and ADELE B. COWAN,

Petitioners,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.,
a corporation,

Respondent.

SUPPLEMENTAL BRIEF OF RESPONDENT.

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a corporation,

Respondent.

SUPPLEMENTAL BRIEF OF RESPONDENT.

To the Honorable Charles Evans Hughes, Chief Justice, and to the Honorable Associate Justices of the Supreme Court of the United States:

Respondent files this supplement to its principal brief for the following reasons:

1. There are listed specifically herein authorities in support of respondent's position which were mentioned in its principal brief only by reference to the two opinions

of the United States District Court set forth in full in the transcript of the record filed herein by petitioners.

2. This Court's attention is called herein to Corporate Reorganization Release No. 9 of the Securities and Exchange Commission, dated March 24, 1939, *In the Matter of Detroit International Bridge Company, Debtor,* No. 24131, in the United States District Court, Eastern District of Michigan.

I.

In answering petitioners' Point II (Petitioners' Petition, page 27) respondent, in its principal brief, referred, on page 17, to certain authorities as being disclosed in the opinion of the District Court, which authorities show that the Court has a wide discretion with respect to allowing stockholders who contribute additional consideration to a reorganized company to participate in the plan, even though the debtor is insolvent. These authorities are:

In re Georgian Hotel Corporation, 82 Fed. (2d) 917 (certiorari denied 298 U. S. 673);

In re Baldwin Locomotive Works, 21 Fed. Supp. 94;

In re Burns Bros., 14 Fed. Supp. 910;

In re A. C. Hotel Company, 93 Fed. (2d) 841;

In re 333 North Michigan Avenue Bldg. Corp., 84 Fed. (2d) 936 (C. C. A. 7);

Kansas City Terminal Ry. Co. v. Central Union Tr. Co., 271 U. S. 445, at 454;

Gerdes on Corporate Reorganizations, Sec. 1086, p. 1741.

Respondent also calls attention to a decision of the Securities and Exchange Commission entitled:

> *In the Matter of Detroit International Bridge Company, Debtor,* No. 24131, United States District Court, Eastern District of Michigan,

which is set forth in Corporate Reorganization Release No. 9 of the Securities and Exchange Commission, dated March 24, 1939, holding a reorganization plan submitted to the Commission under the provisions of Chapter X of the present Bankruptcy Act (Chandler Bill) to be fair and feasible. In that case the corporation was insolvent to such an extent that the entire assets of the debtor were worth only a fraction of the amount of the first mortgage debt. Nevertheless, debenture holders junior in rank to the first mortgage bondholders, and stockholders, both preferred and common, were allowed to participate in the plan of reorganization on a basis other than the payment of a new cash consideration. The Commission stated that the junior security holders were allowed to participate for the reason that their cooperation was desirable in avoiding expensive foreclosure proceedings, in avoiding litigation, and in obtaining consents to certain charter amendments so as to avoid the necessity of forming a new corporation, with attendant possible difficulties through the transfer of the bridge purchases to such a new corporation.

II.

Respondent's principal brief, on page 21, referred to authorities as being disclosed in the opinion of the District Court, and showing that respondent is not estopped from taking advantage of Section 77B of the Bankruptcy Act by reason of the provisions of Section 5 of Article II of the trust indenture securing the bonds. These authorities are:

In re Weitzen, 3 Fed. Supp. 698;

Federal National Bank v. Koppel, 253 Mass. 157, 148 N. E. 379;

Struthers Furnace Co. v. Grant, 30 Fed. (2d) 576;

In re American & British Mfg. Corp., 300 Fed. 839.

Respectfully submitted,

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OCT 16 1939
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Respondent.

RESPONDENT'S REPLY TO BRIEF OF THE UNITED STATES, AMICUS CURIAE.

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Respondent.

RESPONDENT'S REPLY TO BRIEF OF THE UNITED STATES, AMICUS CURIAE.

To the Honorable Charles Evans Hughes, Chief Justice, and to the Honorable Associate Justices of the Supreme Court of the United States:

STATEMENT OF CASE.

Reference is made to the statement of the case which appears at the opening of respondent's brief in opposition to petition for writ of certiorari.

Under the heading "The Plan of Reorganization" the government states that "in return for a claim for principal and interest $3,807,071, the bondholders will receive but 77% of the assets of the enterprise, represented by securities having a par value, asset value, and a liquidating preference of only $641,375. The remaining 23% will go to the Class A stockholders." This is inaccurate in that under the Plan the Class A stockholders, after a preference of $641,375 to the old bondholders, will then be entitled on liquidation to be paid $188,625 and thereafter the balance of any remaining assets to be liquidated will be distributed pro rata to old bondholders and old stockholders. [R. pp. 60-61.]

The statement of counsel for the government under the heading "Disposition of Plan in the Lower Courts" is not complete or accurate. The decisions of the District [R. pp. 202-245] and Circuit Court [R. pp. 372-380] in the record speak for themselves.

For the purpose of this argument, let us admit the government's statement that the courts have regarded the fairness and equity of a plan of reorganization as a question of law. The petitioners repeat at many points in their brief that they agreed by stipulation [R. p. 285] not to question and also that at no time have they questioned the findings of fact of the District Court. Petitioners do not question the sufficiency of the consideration given by the old shareholders for their right to participate in the Plan. Petitioners merely argue that the old shareholders

cannot participate to any extent whatever where the debtor is found to be insolvent. The government's attack on the fairness of the Plan in this case, however, is made by questioning one of the premises, *i. e.*, findings of fact upon which the District Court based its "conclusion" that the Plan was fair and equitable, to-wit: the sufficiency of the new consideration moving from the old shareholders as a basis for their participation in the Plan. The District Court made findings of fact [R. pp. 320-323] based upon the evidence submitted to it that (a) the Class A shareholders have had the management and control of the debtor and have this right to its management and control until 1944, (b) the bonds of debtor are owned by approximately 757 individuals who are widely scattered and unorganized and it will be beneficial to the bondholders to allow Class A shareholders to participate in this reorganization so as to provide continuity of management, (c) it will be an asset to the new company and its shareholders to retain debtor's Class A shareholders as shareholders of the new company because of their familiarity with the operation of the business of debtor and because of their financial standing and influence in the community, (d) by virtue of the 1930 reorganization payment of interest on the outstanding bonds was waived, unless earned, until 1944 and that for all practical purposes said bonds cannot be foreclosed until they mature in 1944, (e) the principal valuable consideration passing between the bondholders and the stockholders to justify participation of stockholders in the Plan is the virtual abrogation of said agreement deferring foreclosure until 1944, (f) the bondholders cannot now foreclose nor can they acquire the assets securing debtor's bonds without long and protracted litigation which would be expensive and of great

injury to debtor as a going concern, (g) bonding companies are unwilling to assume risk of becoming surety for debtor because of the outstanding bond issue, and that without surety bonds bids cannot be made on the building of new ships and operations are restricted to small repairs, (h) the United States Government is planning construction of many vessels, certain of which debtor is capable of building, and that by reason of said program valuable opportunities are open to debtor to build ships which will be lost to debtor, its bondholders and other interested parties, if litigation is commenced and if the Plan is not approved, (i) the value to the bondholders of maintaining debtor as a going concern and of avoiding litigation is in excess of the value of the stock being issued to the Class A stockholders under the Plan. [R. pp. 320-323.] There was a further valuable consideration flowing from the old shareholders out of the fact that the Class A stockholders were willing to reorganize and permit a cancellation of the trust indenture immediately. The trust indenture required the maintenance of certain northern properties of respondent at an estimated annual expense for said shut-down properties of $21,500. [R. pp. 67-68, 313.] This amount for approximately eight years would have amounted to $172,000 which would have had to be paid out of the assets of respondent were it not for the Plan which provided for an immediate elimination of the trust indenture and this annual expense. Instead of this continuing expense the Plan provides for an immediate liquidation of these northern properties and a

distribution of the proceeds thus realized to the bondholders alone. [R. p. 35.] This, we submit, was a further substantial contribution which the Class A shareholders by their consent and cooperation made possible under the Plan. These are the findings of fact of the District Court. Petitioners in the United States Circuit Court of Appeals were barred and are here barred by their stipulation [R. p. 285] from questioning findings of fact of the District Court. If this avenue of attack is closed to the petitioners, we submit, it is not open to the Government. Furthermore, the record on which the trial court made its findings of fact with respect to relative values is not before this court, the stipulation that findings of fact would not be questioned being substituted for such record.

Summary of Argument as Requested by Paragraph 2(f) of Rule 27.

Answer to Government's statement as to the interest of the United States.

Congress left the findings of fact upon which the fairness of plans of reorganization should be based to the United States District Courts, subject to review on appeal. The Government is urging the Supreme Court to legislate rules to guide the District Courts and other governmental agencies in their fact finding tasks. To grant the Government's demands would plunge the Supreme Court into the legislative field reserved to Congress.

The general public interest can best be served by a disposition by the Supreme Court, case by case, of questions presented in those cases.

I.

Answer to Government's Point I.

The Government's contention that "No PLAN OF REORGANIZATION WHICH FAILS TO GIVE PRECEDENCE TO THE ENTIRE CLAIM OF SENIOR CREDITORS BEFORE PARTICIPATION OF JUNIOR CREDITORS OR STOCKHOLDERS IS FAIR AND EQUITABLE AS A MATTER OF LAW," is not supported by reason or authority.

The standard of fairness controlling in the instant case does not do violence to the *Boyd* case. (*Northern Pac. Ry. Co. v. Boyd*, 228 U. S. 482 [1912].) In the instant case the old bondholders are given all of the assets which were covered by their mortgage plus what they could realize upon by a deficiency action, save and except the 20-plus per cent allocated under the Plan to the old shareholders in exchange for the new consideration contributed by the old shareholders.

II.

We do not take issue with the Government on its Point II that "A PLAN WHICH IS UNFAIR AS A MATTER OF LAW CANNOT BE MADE VALID BY THE CONSENT OF REQUIRED PERCENTAGE OF A CLASS OF SECURITY HOLDERS," but earnestly contend such proposition is not applicable in the instant case.

III.

Answer to Government's Point III.

The Government's contention that "THE ALLEGED 'CONSIDERATION' TO BE FURNISHED BY THE STOCKHOLDERS DOES NOT SUPPORT THEIR PARTICIPATION UNDER THE PLAN" is not tenable.

The petitioners have never raised this question either in their specifications of error or in their brief; therefore the

Government should not be permitted to urge this point. Nevertheless the answer is: the District Court found as a matter of fact that the "consideration" was adequate and the petitioners agreed by written stipulation not to question the findings of fact of the trial court and have not questioned this finding. The evidence upon which the District Court's finding was based is not before this Court because of said stipulation. This Court, in the absence of a record and in the face of the stipulation, we submit, should reach no different decision than the Circuit Court reached, *i. e.*, affirm the District Court's decision. However, debtor submits that the findings of fact made by the District Court as to consideration do support the conclusion of the District Court granting stockholders' participation.

Answer to Government's Statement as to Interest of the United States.

1. The Interest of the United States in Terms of Legal Issues.

Under various statutes, including those referred to in the Government's brief, Congress has delegated a certain fact finding task to the District Courts, subject to review on appeal. So before a District Court can approve a plan of reorganization as fair, equitable and feasible, it must consider the evidence fully and thoroughly and make findings of fact based upon the evidence from which the conclusion may be drawn that the plan is fair, equitable and feasible and not discriminatory in favor of any class of creditors or stockholders. As the number of considered cases increases, there will come into existence a body of law which will constitute a guide to the District Courts to the extent that the decided cases are applicable

to the new cases which are coming up. The Government in its brief urges the Supreme Court to legislate a set of rules at this time which will be a guide to the District Courts and other governmental agencies in their fact finding tasks. To ask this Court to look into the future and set up rules to be applied to all of the different types of cases which may arise in corporate reorganizations is, of course, to ask the impracticable if not the impossible. It is the view of the respondent in this case that the Supreme Court should decide the issues presented before it in this case at this time in accordance with the record presented and that the best interest of the United States will be served if such procedure is followed by this Court. When the next case is presented then, this Court, we submit, should decide that case in the same way. To grant the Government's demands, we submit, would plunge this Supreme Court into the legislative field reserved to Congress.

2. The Interest of the United States in Terms of the General Public Interest.

The Government's counsel states quite frankly that the instant case is not intrinsically of major importance and that the amount involved is not large. The instant case, we submit, is of major importance to the parties involved in the reorganization and affected thereby, to-wit, the bondholders and the stockholders, and prompt and speedy reorganization will be to the best interests of all concerned.

The Government urges that the former bondholders having a first lien are displaced under the Plan and made stockholders "so that a new bond issue may be given precedence to their claim." It should be impressed upon the Court at this point again that any new bond issue that is

imposed upon the property of the debtor as reorganized will have to be voted by the old bondholders who will hold 77% plus of the voting stock of the reorganized company.

Under this heading in the Government's brief there appears what is probably not intentional upon the part of the Government's counsel, but it is clearly a wrong conclusion from a rather clear portion of the record. Government's counsel says: "On the other hand, the stockholders who have no equity in the assets, are allowed 23% of the assets and voting power which, in all probability, will enable them to exercise control of the corporation. [R. 96.]" What the Special Master said, as shown at this page of the record is as follows:

> "While the evidence in favor of permitting the old Class A stockholders, in view of the insolvency of the Debtor, to share on a stock basis with the bondholders, but in a minority and deferred position, might be stronger, the Special Master, after weighing carefully all of the factors involved, has concluded to recommend the approval of the modified plan by the judge. During the course of the hearings before the Special Master it was plainly indicated by objecting bondholders, Thomas K. Case and Adele M. Cowan, that a simple solution of the debtor's problem would be the payment in full of their bonds and all other non-assenting bonds. While a court of equity will not allow minority bondholders to be disregarded or unfairly treated in a reorganization plan, yet, on the other hand, it will not lend its aid to schemes by minority bondholders opposing a fair reorganization plan solely as a means of obtaining greater value or more favorable terms for his bonds than are to be given by the plan to the great

majority of bondholders. The cases on this subject are more or less rigid in their requirement that where insolvency exists the creditors must be fully compensated before old stockholders can be let into the picture at all. However, there are other ways of furnishing adequate compensation than by cash alone. The modified plan provides not only for placing the bondholders in a preferred position as to dividends and upon liquidation, but also for the reservation of a certain amount of Class A preferred stock to be held in the treasury for future use in the raising of money. The present bondholders, as new Class A stockholders, need have no concern over this reservation because their majority control of all of the stock will enable them to control the Board of Directors to the end that the use of this treasury Class A stock will be for wise and useful purposes for the benefit of all concerned. Nor need the bondholders, as the new Class A shareholders, be concerned over the possible creation of new liens against the assets in the new corporation, because such old bondholders, through such majority control, will have full say as to why, how, and when any such liens shall be created. It is true that the old Class A shareholders, the new Class B stockholders, by reason of their being in close touch with the business in the past and their present control of the corporation, may be able to organize more quickly and more concretely in controlling the policies of the new corporation than the old bondholders, the new Class A shareholders, since the latter are widely scattered and out of touch with the business. But this is a chance that the bondholders must take if the company is to be reorganized and put on its feet and not be subject to foreclosure or liquidation." [R. pp. 95-96.]

It is obvious that it is the conclusion of Government's counsel which appears in the Government's brief rather than the conclusion of the Special Master, which is fully quoted from the record above.

The statement is also made by Government's counsel that the Supreme Court has declared again and again that the condition of participation by junior interests in a reorganization plan is the prior satisfaction of all senior claims. No cases, however, are cited to support this broad statement. It is the contention of the respondent that the analysis of the decisions applicable to this case which are presented in respondent's brief and in the able decision of the District Court do not support any such conclusion.

Counsel for the Government has also failed to cite in his brief any authorities to support the proposition that junior interests for whom no equity remains, in order to participate, must contribute "necessary money or money's worth to the reorganized company." It is the position of the respondent, outlined in its briefs with authorities in support thereof, that any participation depends upon the contribution of a valuable, new and additional consideration to the reorganized company. [Respondent's Principal Brief, pp. 16 and 17; Resp. Supp. Brief, p. 2; R. pp. 225, 228.] Forbearance to exercise a right may be just as valuable a consideration as a contribution in money. The stockholders had a right to prevent foreclosure or reorganization and remain in control until 1944 (a period of eight years at the time the Plan was promulgated). That the forebearance or waiver of this right was equal in value to the participation afforded under the Plan to old Class A stockholders was found to be a fact by the Special Master, by the Trial Judge and by 90-plus per cent of the bondholders. This is not a case of giving

stockholders participation to avoid foreclosure and other litigation. Rather it was a participation granted for forebearing a right to control until 1944 which neither litigation nor foreclosure could disturb.

Counsel for the Government states that in the case under consideration the Court can see "devices by which stockholders faced with the consequences of the risk taking position which they have voluntarily assumed, have sought to conjure up considerations and to bargain, sometimes successfully, with valueless rights against the real money and real property of the bondholders. We have, in short, relatively simple examples of typical methods by which, too often with judicial aid and comfort, stockholder interests have frequently succeeded in whittling down the principles intended by this Court for the protection of creditors." These are high sounding phrases and may apply in some reorganizations but they do not fit the instant case. At the outset, the Debtor Corporation in 1936 was managed by a board of directors voted into office by the old Class A shareholders. [R. pp. 100-101.] They were in control of the debtor and its assets and the trust indenture securing the income bonds held by the bondholders could not be in default and foreclosed until 1944. [R. pp. 76, 320-321.] Profitable shipbuilding business of any magnitude, with attendant profits, could not be undertaken with the top-heavy lien of the bond structure because surety company completion bonds could not be obtained. [R. p. 322.] The stockholders did not have to "conjure up considerations and to bargain * * * with valueless rights against * * * the bondholders." There existed, by reason of the 1930 reorganization, the right to management and control with no fear of foreclosure until 1944. [R. p. 320.] For the Government to

say that the stockholders had to conjure up this right or that it was valueless is to beg the question.

After months of study and consideration, the board of directors of Respondent prepared and Respondent presented the Plan of Reorganization to the Division of Corporations of the State of California on February 13, 1937 [R. p. 145] and after a public hearing, of which notice to all creditors and stockholders of respondent was given, the Division of Corporations of the State of California issued a permit dated June 14, 1937 [R. pp. 42-44] to Respondent wherein the terms and conditions of the proposed issuance of certificates of deposit was held to be fair and the respondent was permitted to solicit consents to the Plan from its stockholders and bondholders. This Plan contemplated two methods of consummation: either (1) by consent of the parties, or (2) a Section 77B proceeding, and that the method to be followed would be determined by the board of directors of respondent.

Prior to the filing on January 28, 1938, [R. p. 309] of the voluntary petition under Section 77B by respondent, the Plan was properly accepted by the holders of over 90% in amount of the outstanding bonds; over 99% in amount of the outstanding Class A stock, and over 89% in amount of Class B stock. [R. pp. 207, 313.] Respondent's board of directors, in the exercise of its discretion, determined that this percentage of bonds was not near enough 100% to warrant consummation of the Plan without a 77B proceeding. [R. pp. 80, 313.] A voluntary petition under the provisions of Section 77B was then filed. But at that time respondent, by voluntary agreement with its affected security holders, *i. e.*, its shareholders and bondholders, had a Plan which was consented

to by more than the requisite percentages required by Section 77B.

The Plan proposed in respondent's original petition [R. p. 88] contemplated a stock division of 71% to bondholders and 29% to old Class A stockholders. As a result of the negotiations between bondholders' representatives and respondent during the hearings before the Special Master, a modified Plan was formulated and presented by respondent changing the percentages to approximately 77% to bondholders and approximately 23% to Class A stockholders, respectively, and with the other differentiating features described elsewhere in the briefs and in the record. [R. pp. 207-210.]

Counsel for the Government emphasizes the necessity of eliminating top-heavy debt structures in corporate reorganizations, so as to avoid future reorganizations. That was one of the ends sought to be accomplished in the present reorganization by having a simple stock structure of preferred and common stock which was not top-heavy and wherein the dollar par value of the outstanding shares equaled the appraisal value of the fixed and current assets at the time of the reorganization. [R. pp. 80, 206-207.]

Much is said in the Government's brief as to the theory of dealing with priorities in corporate reorganizations. From a practical point of view in many reorganizations, certain of the theoretical views and rules are not applicable. There are usually no clear cut lines of demarcation. A typical illustration would be an insolvent corporation with a first mortgage bond issue covering all of its assets which are mortgageable by law, a number of unsecured creditors, and some stockholders. At the time of the preparation of a reorganization plan, if there were

cash in bank and other current assets, the question of law would have to be determined as to what were mortgageable assets. The cases are quite clear that cash in bank and accounts receivable, until reduced to the possession of the bond issue trustee, are not subject to the lien of the trust indenture. If there were mortgaged and unmortgaged assets and if the value of all of the mortgaged assets at the time of the reorganization was less than the total claim under the bond issue trust indenture, it would then be necessary to arrive at a fair valuation of the property which was subject to the mortgage and allocate said amount exclusively to the bonds. The second step would then be in order, *i. e.*, a fair proration of the unmortgaged assets between the deficiency of the bond claim and the amount of the claim of the unsecured creditors. No one will question that a fair treatment is accorded to the bondholders and the unsecured creditors provided all assets were evaluated fairly and the bondholders were given all the assets, legally mortgaged, and provided further that the proration of the unmortgaged assets between the deficiency claim under the trust indenture and the claim of the unsecured creditors is a fair and equitable proration. It must be borne in mind that when you come to the second step that each of the claims applies equally to all of the unmortgaged assets. In such a case, the junior issue (unsecured creditors) would participate before a senior issue was provided for in full.

Let us now briefly see how the instant case may be compared with the foregoing hypothetical case. The mortgaged assets, including those which can be reached by deficiency action through the pledge of the shares of the subsidiary company under the trust indenture, to-wit: the current assets, including cash in bank, are very much

less than the total claim of the bondholders under the trust indenture. [R. p. 206.] There are no unsecured creditors affected by the Plan. [R. p. 326.] The old stockholders and the bondholders have rights which at the same time extend and apply to the whole of the assets of respondent. The stockholders' right to control until 1944 applies to all of the assets, as does the lien of the bond indenture. The first step on the hypothetical case could be omitted in the instant case. It was therefore necessary in arriving at a fair plan as between the stockholders and the bondholders to prorate, fairly and equitably by value, the interest of the shareholders in the entire assets of respondent and the interest of the bondholders in said assets since the rights of each group applied to the whole thereof.

As pointed out above, this was done voluntarily by respondent, its stockholders and bondholders prior to the filing of the petition under Section 77B. During the hearings before the Special Master and the Court in the 77B proceeding, as heretofore stated, this proration was varied to a point where the Special Master recommended and the Court determined that a fair bargain (to use the language of the Government's counsel in his brief) had been reached. This determination by the Court was based upon the evidence introduced and full and complete findings of fact were made by the Special Master and the District Judge, heretofore referred to and quoted in part in this brief and set forth in the record.

We submit that this proration in the instant case is a fair and equitable application of the priority theory as recognized by the decisions of this Court and discussed at length in the Government's brief.

Another point made by counsel for the Government in discussing the general public interest is that in the use of reorganization machinery, managements perpetuate their management prerogatives. This was not the purpose, intent or result of the instant reorganization. As clearly pointed out in the Plan [R. p. 36], the management and the voting control of respondent under the Plan is to be surrendered to the bondholders. The Plan safeguards this feature [R. p. 61] by the fixing of a date for the meeting of the stockholders of the new corporation within ninety days after its incorporation, or within such further extension of time as may be provided by order of the Court, and in connection with such election the new corporation is not to take any part in the election of the new board of directors except to send out the formal notice and the usual form of proxy, without designation of a proxy holder, and any and all persons desiring to solicit votes or proxies will have to do so entirely at such person's own expense. We repeat that in the instant case there is no attempt to continue control by the present management of respondent and we submit that the bondholders approved the Plan prior to the filing of the 77B proceeding on the basis and for the consideration that they, the bondholders, were obtaining from the stockholders by means of the Plan the immediate opportunity to control respondent and

its assets which otherwise, but for the Plan, the bondholders would not have been able to obtain until 1944. This Plan was to be carried out either outside or inside 77B proceedings.

The avoidance of expensive litigation is urged by the government as not being a proper consideration for permitting the participation of stockholders and other junior interests in a plan of reorganization. In general we agree with the government on this point and submit that this element—the avoidance of expensive litigation—was not the primary factor, but only a minor factor which motivated the trial court in making its findings.

In answering the government's point as to the interest of the United States in terms of general public interest in this case, we have touched upon various phases of the position of respondent in general, for this was the approach of counsel for the government in presenting the point. We would again respectfully submit that the greatest general public interest can best be served by a disposition by the Supreme Court, case by case, of questions presented to it, and not by acting upon the request of the government made in its brief that this Court lay down in this case a set of general rules or a yardstick to guide the United States District Courts and other governmental agencies in their fact finding tasks which have been delegated to such courts and agencies by Congress.

We therefore urge this Court to decide this case on the record as submitted, and we are confident that this course will be followed by the court.

I.

Answer to Government's Point I.

The Government erroneously contends that "No PLAN OF REORGANIZATION WHICH FAILS TO GIVE PRECEDENCE TO THE ENTIRE CLAIM OF SENIOR CREDITORS BEFORE PARTICIPATION OF JUNIOR CREDITORS OR STOCKHOLDERS IS FAIR AND EQUITABLE AS A MATTER OF LAW."

We have already pointed out that when both junior and senior creditors have an interest in the same assets, an evaluation of these interests may clearly require that junior creditors participate before the entire claim of senior creditors is given precedence. Debtor has no quarrel with the holding of this Court in the case of *Northern Pacific Railway Co. v. Boyd,* 228 U. S. 482 (1912), and related cases referred to by government's counsel, provided the holdings in the cases are properly stated and properly applied. This Court in the *Boyd* case refused to sustain a reorganization where a part of the mortgaged assets was taken from the bondholders and allocated to the stockholders to the detriment of an unsecured general creditor whose position was junior to that of the bondholders and senior to that of the stockholders. We submit that this is all that the *Boyd* case held and all that we have said earlier in this brief with respect to the priority rule and the fairness of the plan in this case in dealing with the old Class A shareholders and bondholders of respondent is applicable at this point.

The principle of the *Boyd* case is not abrogated by Section 77B of the Bankruptcy Act or the Chandler Bill, and, while there have been numerous decisions of the

District Courts and Courts of Appeal involving Section 77B since its adoption, many of which have been reviewed and cited in the briefs on file in this case, we submit that in the main the courts have undertaken to carry out the legislative intent of Congress as expressed in these acts. The able decision of the District Court in this case, we submit, clearly sets forth the possibilities and difficulties of corporate reorganizations under the law as it existed prior to the enactment of Section 77B and the purpose and end sought to be attained by the enactment of that section by Congress. We also submit that the District Judge made a correct application of the law to the facts of the instant case. In the District Court's careful consideration of the plan and the problems of respondent and its security holders [R. pp. 202-245] weight is given to the evidence in the case as to the expression of the wishes on a democratic basis of the bondholders and the stockholders. We submit, however, that no undue weight is given to the fact that substantially all of the bondholders had consented to the plan prior to the 77B proceeding in which the District Court confirmed the plan as modified. The District Court said in its opinion [R. p. 229] that, "There does not seem to be any difference of opinion among those bondholders who believe the stockholders should have participation," and that "The only two objectors apparently are the dissenting bondholders—holding $18,500.00 face value of the bonds—who want to be paid off in full, and who are opposed to bondholders who deposited under the 1930 reorganization and stockholders getting anything until they

are so paid." The objectors referred to are the petitioners before this Court. [R. pp. 242-243.]

The District Court, in facing the problem of the participation of the old stockholders, specifically stated the question in its opinion [R. p. 230] as follows:

> "This Court's problem, therefore, is simply this: May the old stockholders be allowed anything?"

And in answering the question stated the Court said [R. p. 233]:

> "Under the modified plan, since the bondholders are given a very substantial majority of the new stock, they at all times will control the new corporation by having the legal capacity to elect a majority of the Board, and may even liquidate the corporation. Actually the bondholders are being given practically everything they could get after they had gone through the trouble, expense and delay incident to foreclosure —even if a foreclosure could be had in spite of the moratorium agreement. The exception is this: they are possibly foregoing a 23/100ths interest in the business in consideration of an immediate reorganization. We say 'possibly' because of the preference given to preferred stockholders upon liquidation, which may give them *all* the assets instead of 77/100ths thereof. Bondholders apparently believe that a bird in the hand is worth two in the bush; that a seventy-seven percent. preferential interest in the profits of a growing business may pull them out entirely, and that an immediate forced liquidation might bring them very little return."

II.

Answer to Government's Point II.

Counsel for debtor do not take issue with the Government on the general proposition in its Point II that "A PLAN WHICH IS UNFAIR AS A MATTER OF LAW CANNOT BE MADE VALID BY THE CONSENT OF REQUIRED PERCENTAGE OF A CLASS OF SECURITY HOLDERS." We do, however, wish to respectfully call the attention of this Court to the fact that counsel for the Government has argued this point in great detail, with exhaustive citation of authorities, but we submit that the point discussed and authorities cited have no bearing whatever on the instant case.

III.

Answer to Government's Point III.

The Government contents that "THE ALLEGED 'CONSIDERATION' TO BE FURNISHED BY THE STOCKHOLDERS DOES NOT SUPPORT THEIR PARTICIPATION UNDER THE PLAN."

We will not lengthen this brief at this point by repeating the argument set forth briefly in that portion of this brief answering the Government's proposition that the public interest is involved.

Government's counsel refers to the *Kansas City Terminal* cases (271 U. S. 445, 455-456) and calls attention to that portion of the Court's decision in which it is stated that "circumstances may justify an offer of different amounts of the same grade of securities to both creditors and stockholders." In the instant case different amounts of the same class of capital stock [R. p. 12] were offered to and a plan was accepted by substantially all of the bondholders and the stockholders of respondent prior to the filing of the voluntary petition in

77B. The bondholders agreed to accept approximately 71% of the shares of common stock and the stockholders agreed to accept 29% of the same grade of stock. This was the original plan which was covered by the permit of the Division of Corporations of the State of California after a public hearing of which all bondholders and stockholders were notified and at which they had an opportunity to be present and to be heard, and based upon which hearing the Division of Corporations issued its permit granting authority to the debtor to solicit consents thereto. During this proceeding [R. p. 88] the basis was changed to 77% to the bondholders and 23% to the old Class A stockholders, and the bondholders were to receive preferred and the old stockholders common stock, respectively.

Counsel for the Government again at this point in their brief refer to the old Class A shareholders as "representatives of valueless interests" and also state that "the attempt now is to justify participation for these interests not upon the basis of a cash consideration or even its equivalent but upon the basis of a 'consideration' which, at best, is technical, and at times wholly specious. The present case is but one instance in which such efforts have thus far met with success." This type of argument on the part of Government's counsel, as heretofore pointed out in this brief, merely begs the question. Counsel for the Government has attempted to state the substance of the findings of fact of the District Court as to the basis for the participation by A shareholders. The findings of fact of the District Court are clearly set forth in the record which speaks for itself.

It is the position of debtor that the petitioners before this Court bound themselves by a written stipulation not

to attack the findings of the District Judge, and the petitioners have repeatedly reiterated in their brief that they have lived up to that stipulation. Counsel for debtor submit that at no point in the petitioner's specifications of error or in their brief have they questioned the findings of fact of the trial court as to the value or adequacy of the consideration furnished by the stockholders to support their participation under the plan. The position of the petitioners has at all times been that "the Court erred in concluding under the circumstances disclosed in this case, that present stockholders of an insolvent corporation, in which they had no equity, could participate in the Plan of Reorganization, either to the extent of 23% or any other percentage." (Petitioner's Br. p. 27.) The insolvency of respondent is the ground of attack by petitioners and not the inadequacy flowing from the stockholders.

As pointed out elsewhere in this brief, the Government should not be permitted to urge points on this appeal which cannot be and are not raised or urged by the petitioners.

The Government urges that the findings of the District Court as to the value to the new company to retain the present Class A stockholders and their interest in the business was apparently regarded as sufficient by the District Court to support the conclusion that the plan was fair and equitable and permit the stockholders to have a stock interest. There is nothing in the record that would warrant the expression of this opinion on the part of Government's counsel. It is the contention of respondent that this element in the consideration was of minor importance with the District Court and with the

Special Master, as is clearly indicated by the report of the Special Master and the opinion of the Court. It was certainly not a vital element in the Plan of Reorganization or appropriate provisions would have been included with respect to a management contract or voting trust control to insure continuity of management. The respondent and all interested parties were content to permit the matter to rest upon a hope that the old Class A shareholders, having been allocated a participation in the reorganized company, would continue their interest. The management expressed such a willingness. [R. p. 227.] The "principal valuable consideration" [R. p. 321] passing between the bondholders and the stockholders to justify participation of the stockholders in the plan is the virtual abrogation of said agreement deferring foreclosure until 1944.

Counsel for the Government argues that there was no such right once the petition for reorganization was voluntarily filed by the stockholders who controlled the respondent. The weakness of this argument is that the Plan of Reorganization was agreed to by substantially all of the stockholders and substantially all of the bondholders and became a contract right between them and respondent before the voluntary petition was filed. As a part of this plan it was optional with the board of directors of the respondent to determine whether to consummate the plan by a voluntary reorganization, if sufficient consents could be obtained, or to complete it by a 77B proceeding. This contractual right in the stockholders, created under the Plan of Reorganization thus agreed to before the adoption of the 77B proceeding, exists today and the plan was binding on the stockholders and the bondholders consenting thereto before the filing of the

voluntary petition, it was binding after the filing of the voluntary petition, and would be binding if the petition were dismissed. If the position of the debtor is sound, that surrender of the right of control for an eight-year period was adequate consideration for a minority and junior participation by the old Class "A" stockholders, such right of participation was secured by contract before, and as a condition precedent to, the institution of the 77B proceedings. Surely nothing would be more unfair or inequitable than a holding that the surrender of a consideration on condition ceases to be a consideration for such condition because it was surrendered. Over 90% of the bondholders would be estopped to make any such claim as they were parties to the contract under which the consideration was surrendered to them. This is not a case of stockholders making a contract for participation in advance of 77B for a wholly inadequate and unfair consideration. Rather, it is one where the contract was for an adequate consideration, to-wit: surrender of eight years' control, and Government counsel contends that this consideration lost its efficacy when surrendered in accordance with the contract.

The argument advanced by counsel for the Government that after approval of the petition, debtor was powerless to withdraw and dismiss the petition, even though the requirements of a fair plan precluded the participation of the Class A shareholders, is not sound because it is submitted that the consenting bondholders and the consenting shareholders to the voluntary proceeding instituted

prior to the filing of the 77B proceeding were bound by their contract and that a court of equity would not abrogate such a contract made in good faith, but on the contrary would enforce a specific performance thereof.

The Government's argument that there was no fresh contribution in money or money's worth and that no contribution can be found in the surrender of a right already waived, is without merit. As pointed out above, the contract or Plan of Reorganization was entered into between the parties before the institution of the reorganization proceedings in Court. The consideration flowing from the stockholders passed, or an agreement with respect to its passage was entered into, and in the same agreement the participating interests of the stockholders and bondholders who were parties thereto in the assets of the debtor were fixed. The parties contemplated the possibility of a 77B proceeding and that the plan might be carried out in that way if it was deemed necessary by the board of directors of respondent and for the best interests of the company and its security holders. [R. p. 35.] It is submitted that a step provided for therein by the parties as a means to carry out the contract cannot, when said step is taken, be urged as a ground for avoiding the contract or making worthless the consideration which was the basis thereof.

The Government argues that the District Court could not properly place any value on the abrogation of the right to postponement of foreclosure until 1944 because the Government argues that that right was surrendered upon

the filing of the 77B petition. We submit that the District Court's conclusion was sound that a dismissal was the only fair and equitable alternative if the Plan was not confirmed in view of the fact that the reorganization plan was entered into by Respondent and substantially all of its bondholders and stockholders before the voluntary proceeding under Section 77B was instituted.

We submit that the opinion of the District Court clearly discloses the weight which it gave to the saving of expense and the avoidance of lengthy litigation. It is the position of the debtor that the attitude of the stockholders in this matter was not that of a "dog in the manger," or an obstructionist. The stockholders in control of the board of directors of debtor in 1936 and 1937 were the moving parties to develop and propose this constructive plan of reorganization for the best interests of all of the security holders of debtor.

As to the element involved in maintaining the debtor as a going concern, this was a saving to the enterprise brought about by the willingness of the stockholders to cooperate and abrogate the 1930 agreement. The saving of the maintenance expense on the northern properties for eight years, amounting to $172,000.00, would not have been possible were it not for the plan and the consent on the part of the stockholders thereto. It is submitted that this is a consideration for which the stockholders were entitled to compensation. No involuntary proceeding under Section 77B could have been instituted on the motion of the

bondholders. There was no default and nothing was due to the bondholders. There were no other general creditors of the debtor. A 77B proceeding which would eliminate the necessity of foreclosure and maintain the continuity of the debtor as a going concern was only possible through the cooperation and voluntary action of the Class A shareholders who were in voting control of the debtor at the time of the promulgation of the plan in 1937 and also at the time of the filing of the voluntary petition under Section 77B in January of 1938. Therefore, the only possible immediate relief to bondholders and stockholders of debtor (short of 1944) was dependent upon the voluntary cooperation of the Class A shareholders of debtor which was given heartily, based, however, upon the plan of reorganization [R. pp. 25-41], consents to which were solicited under the permit of the Division of Corporations of the State of California [R. pp. 42-44] and which was consented to by the holders of substantially all of the outstanding bonds and stockholders, voluntarily, pursuant to solicitation by respondents, prior to the filing of the 77B proceeding in January of 1938.

It is submitted by counsel for respondent that the consideration flowing from the shareholders to the bondholders is adequate and completely compensates the bondholders for that portion of the assets which are allocated to the old stockholders under the plan; that such was the finding of fact by the trial court; that petitioners before this Court have not attacked that finding and were bound by stipulation not to do so; that the Government cannot

raise any point in this appeal not raised by the petitioners; that a full record upon which such finding is made is not before this Court, but that if this Court desires to analyze the conclusions reached by the trial court on this point based upon the limited record before it, this Court should reach the same conclusion as was reached by the District Court and the Circuit Court of Appeals that the consideration flowing from the old stockholders to the bondholders was adequate to support the participation of the old stockholders under the plan.

Respectfully submitted,

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Nos. 23 and 24

In the Supreme Court of the United States

OCTOBER TERM, 1939

THOMAS K. CASE AND ADELE B. COWAN, AND ESTATE OF ADELE B. COWAN, DECEASED, PETITIONERS

v.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.

THOMAS K. CASE AND ADELE B. COWAN, AND ESTATE OF ADELE B. COWAN, DECEASED, PETITIONERS

v.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES AMICUS CURIAE

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In the Supreme Court of the United States

OCTOBER TERM, 1939

No. 23

THOMAS K. CASE AND ADELE B. COWAN, AND ESTATE OF ADELE B. COWAN, DECEASED, PETITIONERS

v.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.

No. 24

THOMAS K. CASE AND ADELE B. COWAN, AND ESTATE OF ADELE B. COWAN, DECEASED, PETITIONERS

v.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES AMICUS CURIAE

OPINIONS BELOW

The District Court filed two opinions. The first, filed May 10, 1938, is not reported but appears in the record at p. 156. The second, filed August 6, 1938, is reported in 24 F. Supp. 501 and appears in the record at p. 202. The opinion of the Circuit

Court of Appeals is reported in 100 F. (2d) 963 and appears in the record at p. 372.

JURISDICTION

The interlocutory order of the District Court confirming the plan of reorganization was filed May 12, 1938 (R. 129). The final order of the District Court confirming the plan was filed July 19, 1938 (R. 306). The decrees of the Circuit Court of Appeals affirming the decrees of the District Court were filed January 12, 1939 (R. 381, 382), and the order of the Circuit Court of Appeals denying the petition for rehearing was filed February 9, 1939 (R. 383). Petition for certiorari was filed in this Court March 28, 1939, and was granted May 22, 1939 (R. 385). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

STATUTES INVOLVED

The statutory provisions involved are contained in Section 77B of the Bankruptcy Act (11 U. S. C. 207). The pertinent provisions are set forth in Appendix B, *infra*, pp. 57–74.

QUESTIONS PRESENTED[1]

1. Whether the requirement of Section 77B of the Bankruptcy Act that a plan of reorganization be

[1] Petitioners' arguments with respect to the power of a court under Section 77B to impair the lien of a secured creditor, or

"fair and equitable" necessitates completely compensatory treatment for senior securities before junior securities may participate in the reorganized enterprise.

2. Whether the "consideration" furnished by the stockholders in this case constitutes, as a matter of law, a contribution adequate to justify their participation under the reorganization plan.

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the power of a majority of a class of creditors to bind the minority of that class by their consent to a plan of reorganization, will not be discussed in this brief. So far as these issues presented a question of constitutionality they were decided against petitioners by the District Court (R. 210–218). Petitioners did not question the constitutionality of Section 77B in the Circuit Court of Appeals (R. 380), and in these circumstances there is no occasion for this Court to consider the question. *Duignan* v. *United States*, 274 U. S. 195, 200. The case was not certified to the Attorney General by either of the lower courts as is required when cases involve the constitutionality of an Act of Congress (Act of August 24, 1937, 50 Stat. 75; 28 U. S. C. 401).

In any event, these contentions of petitioners present no substantial questions of statutory construction or of constitutionality in view of the decisions of this Court in *Continental Illinois National Bank and Trust Co.* v. *Chicago, Rock Island & Pacific Railway Co.*, 294 U. S. 648, and *Canada Southern Railway Co.* v. *Gebhardt*, 109 U. S. 527. The constitutionality of the powers conferred on the courts in these respects by Section 77B has been upheld in the following cases, among others, decided by the Circuit Courts of Appeals: *Campbell* v. *Alleghany Corp.*, 75 F. (2d) 947 (C. C. A. 4th), certiorari denied, 296 U. S. 581; *Humphrey* v. *Bankers Mortgage Co.*, 79 F. (2d) 345 (C. C. A. 8th); *Grand Blvd. Investment Co.* v. *Strauss*, 78 F. (2d) 180 (C. C. A. 8th).

STATEMENT

NATURE OF THE PROCEEDINGS

This is a voluntary proceeding for reorganization under Section 77B of the Bankruptcy Act, instituted by the respondent, Los Angeles Lumber Products Company, Ltd., a California corporation (referred to in this brief as the Debtor).

FINANCIAL BACKGROUND OF THE DEBTOR

The Debtor is a holding company. Its only important asset is all the capital stock of a shipbuilding corporation (R. 28, 316). It has outstanding $2,565,500 in bonds, secured by a mortgage on the property of the shipbuilding corporation and a pledge of all the shipbuilding corporation's stock (R. 5–6). The total indebtedness on the bonds, including accrued interest, aggregates $3,807,071 (R. 70, 319).[2] The Debtor also has outstanding 57,788 shares of Class A stock and 5,112 shares of Class B stock (R. 6, 319).

The shipbuilding corporation owns a shipbuilding and ship repairing plant located on leased land at San Pedro, California (R. 29). During recent years the plant has been used for repair work (R. 71). Small operating profits, before depreciation, have been earned, but these have been insufficient to meet current interest on the Debtor's bonds (R. 29).

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[2] Record references to pages 63 to 118 refer to findings in the Master's report, which (with exceptions irrelevant here) were adopted as findings of the District Court (R. 135, 313).

No interest has been paid on the bonds since 1929 (R. 70, 319). In 1930, with the consent of a majority of the bondholders, the trust indenture under which the bonds were issued was amended, pursuant to a provision therein, to provide for a waiver of the existing defaults in interest, and to reduce the interest from a fixed rate of 7½% per annum to a rate of 6% per annum if earned. The interest coupons were made unenforceable until the principal of the issue matured in 1944 (R. 74–76, 321).

The present Class A and Class B stock of the Debtor was issued in connection with this voluntary adjustment in 1930. The existing stock was wiped out by an assessment, and the new Class A stock was issued to stockholders who paid in $400,000 (R. 75, 320). The Class B stock was issued to bondholders who were willing to accept it in payment of defaulted interest (R. 76).

The physical plant of the shipbuilding corporation was appraised in 1936 at $465,000 as a going concern (R. 9, 31). At the time of the institution of the reorganization proceeding there were current assets of approximately $365,000, thus giving a total value to the enterprise for reorganization purposes, as found by the District Court, of approximately $830,000 (R. 31, 316). This amount, of course, is far less than the aggregate of $3,807,071 of principal and accrued interest on the first mortgage bonds. The District Court found the

Debtor to be insolvent in both the bankruptcy and the equity sense (R. 140, 319).

THE PLAN OF REORGANIZATION

Despite the insolvency of the Debtor, the plan, which was confirmed as "fair and equitable" under the statute, contemplates the participation in the reorganized company not only of the bondholders but also of the holders of the Class A stock (R. 25, 58, 345).

In brief, it provides for the creation of a new corporation with a capital structure of 1,000,000 shares of authorized $1 par value voting stock. The stock is divided into 811,375 shares of preferred stock and 188,625 shares of common stock.[3]

In exchange for their bonds, the bondholders will receive 641,375 shares of the preferred stock.[4] This is on the basis of 250 shares for each $1,000 bond and accrued interest. The Class A stockholders will receive 188,625 shares of common stock (R. 344–345).

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[3] The preferred stock will be entitled to a 5% noncumulative dividend, after which the common stock is to receive a similar dividend. Thereafter both classes share equally in the dividends. On liquidation the preferred receives a preference to the extent of its par value, then the common receives a similar preference, and thereafter both classes share equally.

[4] The balance of 170,000 shares of preferred stock is reserved for sale in order to raise funds for the rehabilitation of the plant, although beyond this the plan contains no suggestion as to how the funds are to be raised (R. 26).

The par value of the total proposed issue of preferred and common stock to existing security holders will equal the estimated going concern value of the assets of the enterprise. Accordingly, in return for a claim to principal and interest aggregating $3,807,071, the bondholders will receive but 77% of the assets of the enterprise, represented by securities having a par value, asset value, and liquidating preference of only $641,375. The remaining 23% will go to the Class A stockholders.

The plan was assented to by holders of approximately 92.81% in amount of the outstanding bonds, 99.75% of the Class A common stock, and 90% of the Class B common stock (R. 210, 327). The petitioners are dissenting bondholders owning $18,500 face value of the bonds (R. 247, 256).

DISPOSITION OF THE PLAN IN THE LOWER COURTS

In approving the plan as "fair and equitable" under the statute, the District Court justified the participation in the reorganized company allotted to the Class A stockholders primarily on the ground that they had furnished a "consideration" warranting the issuance of the new stock to them. This conclusion was based partly on the theory that, as a result of the reorganization, the Class A stockholders would abrogate the 1930 agreement, in so far as it had the effect of deferring any foreclosure proceedings until 1944, when the principal of the bonds was to mature. It was also based on a finding that the retention of the present Class

A stockholders as stockholders would be an asset of value to the new company because of their familiarity with the business, and because of their financial standing and influence in the community (R. 321–323).

In affirming the action of the District Court the Circuit Court of Appeals took the position that it could not look behind the trial court's conclusion that the plan was "fair and equitable," because of a stipulation by the petitioners that "they intend to raise questions of substantive law only; that they will not attack the findings of the trial court on the ground that they are unsupported by evidence * * *" (R. 285). Hitherto, however, the courts have regarded the fairness and equity of a plan of reorganization as a question of law.[5] Moreover, among the points reserved for appeal in the stipulation were Point 2, which alleges that the trial court erred in allowing the stockholders of the insolvent corporation to participate in the plan, and Point 6, which alleges that the plan is "neither

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[5] Appeals from orders confirming plans under Section 77B had to be taken under Sec. 24 (b) of the Bankruptcy Act, *Meyer* v. *Kenmore Granville Hotel Co.*, 297 U. S. 160, and prior to the amendments of 1938 were restricted to the review of questions of law. Bankruptcy Act, Section 24 (b), 11 U. S. C. 47 (b) (prior to 1938 amendments); *Price* v. *Spokane Silver & Lead Co.*, 97 F. (2d) 237 (C. C. A. 8th, certiorari denied, 305 U. S. 626); *Texas Hotel Securities Corp.* v. *Waco Development Co.*, 87 F. (2d) 395 (C. C. A. 5th). The various circuit courts of appeals have, on review under Sec. 24 (b), examined the fairness and equity of the reorganization plans involved in such appeals from

fair, equitable, nor feasible" (R. 286). It would appear, therefore, that the parties themselves have reserved the question of fairness and equity as a question for determination on appeal.

STATEMENT OF INTEREST OF THE UNITED STATES

Neither the United States nor any agency thereof is a party to this case, or immediately interested in its outcome. However, the case involves the interpretation of a statutory standard of vital importance in the reorganization of corporations—the standard by which plans of reorganization effected under the laws of the United States are to be found "fair and equitable." This brief is filed by the United States as *amicus curiae* in order to urge upon the Court the importance of a definitive judicial interpretation of that standard, and to assist the Court in arriving at such an interpretation.

(1) *The interest of the United States and its agencies in the legal issues*

In their administration of laws relating to corporate reorganizations, agencies of the United

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orders of confirmation. *Downtown Investment Ass'n* v. *Boston Metropolitan Bldgs.*, 81 F. (2d) 314 (C. C. A. 1st); *In re Barclay Park Corp.*, 90 F. (2d) 595 (C. C. A. 2d); *Price* v. *Spokane Silver & Lead Co.*, 97 F. (2d) 237 (C. C. A. 8th, certiorari denied, 305 U. S. 626). (In these last two cases orders confirming plans were reversed because the plans were not fair and equitable.) If the fairness of the plan is a question of law, the parties cannot, of course, foreclose the Court's consideration of the question by stipulation. *Swift & Co.* v. *Hocking Valley Ry. Co.*, 243 U. S. 281.

States, particularly the Interstate Commerce Commission and the Securities and Exchange Commission, are confronted, in a variety of situations, with the duty of determining whether plans of reorganization are fair and equitable.[9]

Under Section 77 of the Bankruptcy Act, 11 U. S. C. 205, which relates to railroads, no plan of reorganization may be approved by the district court unless the court finds, among other things, that the plan is fair and equitable, and unless the plan has been first approved by the Interstate Commerce Commission. There are now pending before that Commission 30 reorganization proceedings involving 61,600 miles of operated railroad.

Chapter X of the Bankruptcy Act, 11 U. S. C. 501–676, which today provides the mechanism for the reorganization of corporations other than railroads, also conditions judicial approval and confirmation of a plan of reorganization upon a finding that the plan is fair and equitable. By virtue of Section 208 of chapter X, 11 U. S. C. 608, the Securities and Exchange Commission participates in proceedings under that chapter, and is deemed a party in interest with a right to be heard on all matters arising in the proceeding. On October 1, 1939, that Commission was a party in over 100 cases under the Act. Furthermore, Section 172 of chapter X, 11 U. S. C. 572, imposes upon that Commission the duty of examining and reporting

[9] The text of the provisions of the statutes which impose these duties are set forth in Appendix B, *infra*, pp. 61, 66–74.

on plans of reorganization referred to it for that purpose by the district judge. It is therefore essential for the Commission, under chapter X, to interpret and apply the term "fair and equitable" to the plans which come before it for consideration and report.

Section 77B of the Bankruptcy Act (the predecessor of chapter X[1]), under which this case arose, did not provide for participation by the Securities and Exchange Commission. The requirement that plans be "fair and equitable" is present, however, in both statutes. Moreover, chapter X is applicable to reorganizations begun under Section 77B to the extent that the judge deems such application practicable (Section 276. c.). Accordingly, the Securities and Exchange Commission may be concerned with the fairness of plans of reorganization in proceedings begun before the enactment of chapter X, and is in fact now a party in a number of such cases.

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[1] Section 77B was amended by the Act of June 22, 1938, and incorporated into chapter X of the Bankruptcy Act. Under Section 276. c. (2) of the amendatory Act, 11 U. S. C. 676. c. (2), provisions of Section 77B continue to govern proceedings in which the petition was approved more than three months prior to the effective date of the amendatory Act, September 22, 1938, to the extent that the judge does not deem the application of chapter X "practicable." The standards governing the exercise of the district judge's discretion under Section 276. c. (2) are discussed in *In re Old Algiers, Inc.*, 100 F. (2d) 374 (C. C. A. 2d); *In re Philadelphia & Reading Coal & Iron Co., Appeals of Schrager*, 105 F. (2d) 354 (C. C. A. 3d). The petition in the present case was approved on January 28, 1938 (R. 63, 310).

Apart from bankruptcy legislation, the Securities and Exchange Commission is interested in the criteria of "fairness" applicable to plans of reorganization by virtue of Section 11 of the Public Utility Holding Company Act of 1935 (15 U. S. C. 79k), which in substance requires that no plan of reorganization for a registered holding company or subsidiary thereof in a court of the United States shall become effective unless such plan has been approved by the Commission.[8]

Thus both the Interstate Commerce Commission and the Securities and Exchange Commission are interested in an authoritative declaration of the principles governing the interpretation of the terms "fair and equitable," as used in statutes of the United States, not only as such interpretation may provide the guide to the proper recognition of the priority of senior interests over junior interests in reorganization, but also as it may define the limits of the right of stockholders or junior creditors to participate in the assets of reorganized companies on the basis of contributions of cash or its fair equivalent.

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[8] Subsection (f). In addition, subsection (g) makes it unlawful for any person to solicit, by use of the mails or any means or instrumentality of interstate commerce or otherwise, any proxy, consent, authorization, power of attorney, deposit or dissent in respect of any reorganization plan of a registered holding company or subsidiary company, unless the solicitation is accompanied or preceded by a copy of a report on the plan which shall be made by the Commission.

(2) The public interest in economic aspects of the doctrines involved

The interest of the United States is based upon considerations broader than may be apparent from the mere statement of the duties of its agencies. For that reason it is deemed appropriate before entering upon a detailed discussion of the legal issues to point out, against the illustrative facts of this case, the general effect of the doctrines to be discussed as they impinge upon the national economy. In our view the decision of this case should guide the proper disposition of thousands of corporate reorganization cases.* The manner of their disposition bears vitally on problems of general economic importance, involving both the protection of the rights of countless individual investors and the assurance of sound corporate finance.

This Court has several times declared that the condition of participation by junior interests in a

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*During the period June 7, 1934 (the effective date of Section 77B), through October 31, 1938, the following number of cases were instituted: 930 cases in 1934 (7 months); 1,830 cases in 1935; 955 cases in 1936; 980 cases in 1937; and 822 cases in 1938 (10 months). Hearings before the Subcommittee of the House Committee on Appropriations, 76th Cong., 1st Sess. (1938–1939), p. 375.

From September 22, 1938 (when chapter X, successor to Section 77B, became effective), to March 31, 1939, a total of 251 new cases were begun thereunder. S. E. C. Statistical Series, Release No. 249 (May 8, 1939).

reorganization plan is the prior satisfaction of all senior claims. This has been called the doctrine of "absolute priority." As we shall point out hereafter, no deviation from this principle of fairness has appeared in the decisions of this Court, and very little express deviation from it is apparent in decisions of the lower courts. However, while paying lip service to the rule, the lower courts have at times exhibited a tendency to sanction plans which circumvent the rule.[10] Their decisions lead, if not to denial of the doctrine, at least to its nullification.

Since the enactment of Sections 77 and 77B this tendency has been supported by an argument, to which various *dicta* lend themselves, that the doctrine of fairness laid down by this Court[11] has, by legislative fiat, been displaced by a so-called "composition" theory.[12] And the recognized corollary of the absolute priority doctrine—the rule that junior interests for whom no equity

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[10] A detailed analysis of these cases in equity reorganizations is contained in Foster, *Conflicting Ideals for Reorganization*, 44 Yale L. J. 923 (1935); Bonbright and Bergerman, *Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization*, 28 Col. L. Rev. 127 (1928); Note, *The "Fair" Plan in Corporate Reorganization*, 35 Col. L. Rev. 391, 549 (1935).

[11] *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482 and related cases discussed *infra*, p. 24 *et seq.*

[12] In the present case the District Court quoted approvingly another opinion which advanced this "composition" theory (R. 216–218). This is discussed *infra*, p. 29 *et seq.*

remains may nevertheless be allowed to participate if they are willing to contribute necessary money or money's worth to the reorganized company—has been perverted into a device for depriving senior interests of the property values which this Court has held them entitled to retain.

Intrinsically the case before the Court may not be of major importance. The corporate structure being reorganized is simple. The detrimental economic consequences which flow from a cumulative abuse of the reorganization system will not be greatly aggravated by the confirmation of this particular plan. But the very simplicity of the case lends it significance in the law of reorganization. Here, unobscured by complex detail, can be seen the devices by which stockholders, faced with the consequences of the risk-taking position which they have voluntarily assumed, have sought to invoke nebulous considerations and to bargain, sometimes successfully, with valueless rights against the real claims of the bondholders. We have, in short, a relatively simple example of typical methods by which junior interests have frequently succeeded in whittling down the principles established by this Court for the protection of senior interests.

The need for protection of contract rights is sharply outlined by the facts of this case. The plan allocates but 77% of the estimated going-concern value of the assets to the bondholders. In return the bondholders surrender approximately

three-quarters of the principal amount of their claim, accepting 641,375 shares of $1 par value preferred stock in satisfaction of claims aggregating $3,807,071. Moreover, they are displaced from their position as first lienors and become stockholders, so that a new bond issue may be given precedence to their claim. On the other hand, for "consideration" which we shall show to be without basis, the stockholders, who have no equity in the assets, are allotted 23% of the assets and voting power which, in all probability, will enable them to exercise control of the corporation (R. 96).

The effect upon investors of such unsettlement of contract rights hardly needs to be stressed. Senior security holders invest at low interest or fixed dividend rates, foregoing participation in any extraordinary profits of the enterprise in reliance on the greater assurance of safety provided by their contract. In sacrificing profit opportunities they rely, and on the assumption that those who have ventured their capital in the hope of speculative profits will bear the risks of the enterprise, and on the promise that in the event of financial reverses they will be made whole before provision is made for the risk-bearing junior interests. The ultimate measure of their rights is the treatment which their securities receive in reorganization.

In cases of liquidation no one questions the right of senior security holders to full payment before

any distribution of assets to junior interests. Reorganization is an alternative for liquidation in the event of financial failure. It seeks to substitute going concern values for the forced sale values of liquidation, with the object of yielding greater ultimate returns to the senior interests, and allowing wider participation if the values permit. But it presents no occasion or excuse for a different treatment of priorities in disregard of senior contract rights. The obligation of contract has an unreal quality if the terms of the undertaking are dealt with in practice as nothing more than "mere legal verbiage." [13]

The problem, however, bears not only upon the protection of individual investors, but also upon the soundness of reorganized capital structures. It is axiomatic that a successful reorganization requires a readjustment of capital structure to correspond to existing and reasonably estimated future earnings. A top-heavy structure of debt and fixed charges not only creates the danger of default but constitutes an obstacle to the financing of future capital needs through the sale of stock.[14] The history of railroad reorganizations demonstrates that further expansion of an already heavy bonded indebtedness left outstanding after reor-

[13] Dewing, Financial Policy of Corporations (3rd ed. 1934) 1157.

[14] The use of income bonds instead of fixed interest bonds does not cure the difficulty. The former represent a claim to earnings and asset values ahead of stock, and they have fixed

ganization contains the seed of recurrent insolvency.[15]

Yet fixed charges, top-heavy debts, and complicated structures have persisted in corporate reorganizations.[16] This has frequently been due to a failure properly to apply the absolute priority rule. Instead of eliminating valueless claims, a participation has been allotted to all existing security holders. In the attempt at the same time to preserve the priorities of senior security holders, a

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maturities. The presence of substantial issues of stock which no longer reflect asset values but which nevertheless represent a claim to improved earnings likewise restricts the possibility of new stock financing.

[15] *Reorganization Plans as Causes of Recurrent Insolvencies*, Report of the Senate Committee on Interstate Commerce, No. 25, Part 1, 76th Cong., 1st Sess. (1939), p. 2. Approximately 31% of the railroad mileage of this country is being operated by court receivers and trustees and many of the roads thus involved had not long emerged from earlier receiverships: Chicago, Milwaukee & St. Paul (1928), Denver & Rio Grande Western (1923), Chicago & Eastern Illinois (1921), Missouri Pacific (1917), Western Pacific (1915–16), Wabash (1915). Spaeth and Windle, *Valuation of Railroads Under Section 77 of the Bankruptcy Act*, 32 Ill. L. Rev. 517–8 (1938). An exhaustive tabulation of railroad reorganizations by periods, disclosing the recurring appearance of the same roads, is found in Hearings of the Senate Committee on Interstate Commerce on S. 1869, 76th Cong., 1st Sess., p. 36 *et seq.*

[16] An outstanding example of the stratification of security structures in reorganizations is to be found in the 1928

necessary corollary has been that new debts, interest charges, and preferred stocks have been created. Frequently companies have emerged from reorganization with more burdensome debt charges and more complicated capital structures than they had at the beginning of the proceedings. The usual result is an early return to the reorganization fold.

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reorganization of the Chicago, Milwaukee & St. Paul Railroad. All classes of existing security holders were permitted to participate, in part on the basis of a cash contribution by preferred and common stockholders. New securities in the form of bonds, preferred stocks, and common stocks were issued. Interest charges under the plan exceeded the interest charges prior to the receivership. See *Jameson* v. *Guaranty Trust Co.*, 20 F. (2d) 808 (C. C. A. 7th), certiorari denied, 275 U. S. 569; *Chicago, Milwaukee & St. Paul Reorganization*, 131 I. C. C. 673. The railroad returned to reorganization in less than ten years. U. S. District Court, Northern District Illinois, Index No. 60463 (1935).

The plan in the above case has been rationalized in terms of a so-called doctrine of relative priority. See Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade*, 27 Col. L. Rev. 901 (1927); *Bonbright and Bergerman, Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization*, 28 Col. L. Rev. 127 (1928).

In 29 reorganizations of industrial corporations between 1921 and 1929, studied after 1929, fixed charges were increased in 13, remained stationary in 4 and decreased in but 12 cases. *Dewing, Financial Policy of Corporations* (3d ed. 1934), 1246. Only 15 out of 31 Class I railroad reorganizations effected through court proceedings between 1915 and 1933 met a suggested test that fixed charges should not exceed 80% of average earnings for the worst 3 years of the preceding ten (99 Railway Age, 433–434 (1935)).

Economic disadvantages also flow from the issuance of valueless securities in reorganization, securities which reflect neither existing value nor the payment of a fresh contribution by junior interests. It is patently undesirable to place upon the market securities which represent little more than the paper upon which they are written. Such valueless securities create the risk of fraud upon future purchasers, and are peculiarly susceptible to use as media for market manipulations.[17] Commenting on such securities, the Chairman of the Senate Committee on Interstate Commerce has said:

> where you have this large amount of stock without any earning capacity at all, it is just used as a speculative football, to be traded in, and also for the control of the railroad itself.[18]

No less objectionable, from the standpoint both of investors and of the general public interest, is

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[17] The New York Stock Exchange in several cases has asked the Securities and Exchange Commission for permission to strike issues of appreciably reduced asset value from listing and registration on the ground that such issues were particularly vulnerable to manipulation. *Standard Investing Corp.*, S. E. C. Securities Exchange Act Release No. 2046; *Minneapolis, St. Paul & Sault Ste. Marie Ry. Co.*, S. E. C. Securities Exchange Act Release No. 2059.

[18] The stock referred to was that of the Seaboard Air Line Railway, which emerged from receivership some thirty years ago. The stock has never paid a dividend but has been persistently traded in large volume. Hearings on S. 1869, 76th Cong., 1st Sess., p. 449.

the fact that the reorganization machinery permits the holders of valueless interests to perpetuate themselves in control. Although a common stock interest allotted to the old stockholders may be valueless in terms of market or asset value, ordinarily it carries voting control.[19] With voting control the old stockholders may avail themselves of emoluments and indirect benefits which are vastly more valuable than mere dividend possibilities or potentialities of market value. Not only is it patently inequitable to allow the holders of a valueless equity to retain so valuable an interest in the corporation, but it is a commonplace of corporate finance that the perpetuation of controlling common stock interests without asset value invites manipulation of corporate enterprises for the profit of the controlling interests and to the detriment of the corporation itself.[20]

Attempts are encouraged to create asset value by speculative schemes, or by reinvestment of profits in the enterprise at the expense of holders of noncumulative income bonds or preferred stock.[21] If

[19] Moore, *Railroad Fixed Charges in Bankruptcy Proceedings*, 47 J. Pol. Econ. 100, 115, 118 (1939).

[20] An extended study of the benefits of control to such controlling stock interests is contained in Berle and Means, *The Modern Corporation and Private Property* (1932) 153–219. Pertinent also is Commissioner Eastman's testimony in Hearings before the House Committee on the Judiciary on H. R. 6249, 74th Cong., 1st Sess., pp. 282–283.

[21] Dewing, *The Position of Income Bonds as Illustrated by Those of the Central of Georgia Railroad*, 25 Quart. Jour.

contingent charges are cumulative, the controlling equity interests, spurred by hopes of resumed dividends, may be driven to unwise attempts to increase earnings at the expense of adequate property maintenance in order to forestall accumulation of prior charges. If the enterprise is affected with a public interest the public is directly concerned with threatened impairment of service. Even in the case of a wholly private enterprise persistent skimping on maintenance inevitably leads back to reorganization.

Finally, we direct the attention of the Court to the stimulus which uncertainty as to relative rights gives to obstructionist tactics. If the basis for the treatment of contract rights is unsettled, reorganization ceases to be an orderly process of allocating assets in accordance with priorities. Instead it becomes a process of haggling, in which endurance challenges legal position." Junior security holders trade on their nuisance value in order to enforce levies upon the assets. Especially where senior securities are widely dispersed and the valueless equity securities are compactly held by a group or corporation, the threat of protracted litigation

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Econ. 396. An example of the employment of this technique for a similar purpose appears in *MacIntosh* v. *Flint & Pere Marquette R. Co.*, 34 Fed. 582 (C. C. E. D. Mich.).

[11] Spaeth and Windle, *Valuation of Railroads under Section 77 of the Bankruptcy Act*, 32 Ill. L. Rev. 517, 519 (1938).

often becomes an important factor in the formulation of the plan."

We believe, therefore, that these considerations make it evident that this Court should reaffirm the doctrine of absolute priority as applicable to proceedings under the reorganization statutes and foreclose further resort to devices which may be used to nullify its effectiveness.

SUMMARY OF ARGUMENT

The applicable statutory provisions of Section 77B require, as a condition of confirmation of a plan of reorganization, that the court find the plan "fair and equitable." Compliance with the same standard was required in reorganizations effected in equity receiverships, and this Court's decisions in such cases are controlling in reorganizations under Section 77B, as a matter both of statutory construction and judicial interpretation.

A plan of reorganization which fails to give precedence to the entire claim of senior creditors before permitting participation by junior creditors

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[11] The Senate Committee on Interstate Commerce has described the opposition of the Pennsylvania Company and Alleghany Corporation, largest common stockholders of subsidiaries in reorganization (Wabash and Missouri, Pacific Ry., respectively), to the exclusion of valueless junior interests, as leading to reorganizations which would be "mere preludes to repeated bankruptcies". Report No. 25, Part I, 76th Cong., 1st Sess., pp. 18–25. The present case, in which the bonds are publicly held while the Class A stock is closely held, furnishes an apt example. The District Court found that the willingness of the stockholders to forego litigation constituted valuable consideration (R. 323).

or stockholders is not fair and equitable as a matter of law. Such a plan cannot be made valid by the consent of the percentage of a class of security holders required for confirmation of a plan. The plan in the present case fails to give precedence to the claim of the bondholders, and therefore fails to comply with the statutory standard.

The alleged "consideration" proposed to be furnished by the stockholders under the plan fails to meet the conditions upon which the allotment of a participation to the holders of valueless interests, on the basis of a contribution by them, may properly be justified. Therefore, it does not remedy the failure of the plan to comply with the statutory requirements of fairness.

ARGUMENT

I

A PLAN OF REORGANIZATION WHICH FAILS TO GIVE PRECEDENCE TO THE ENTIRE CLAIM OF SENIOR CREDITORS BEFORE PERMITTING PARTICIPATION BY JUNIOR CREDITORS OR STOCKHOLDERS IS NOT FAIR AND EQUITABLE AS A MATTER OF LAW

The standard of fairness which is controlling in this case is derived from *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482, and related cases.[24] That standard, known as the "absolute priority" rule, requires that a plan, to be fair, must pro-

[24] *Railroad Co.* v. *Howard*, 7 Wall. 392; *Louisville Trust Co.* v. *Louisville, Albany & Chicago Ry. Co.*, 174 U. S. 674 (the "Monon" case); *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445.

vide recognition approximating full payment for claims in the order of their priority. As stated by this Court in a later case, a plan of reorganization "which does not give precedence to *the entire claim* of the creditors over any part or interest of a stockholder" is not "sufficient as to unsecured creditors and binding upon them * * *." *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445, 452, 455. (Italics supplied.) The same principle is applicable to the claims of senior creditors as against junior creditors and stockholders.[25]

This is the doctrine of the *Boyd* case as applied by most courts[26] and understood by most legal writers.[27]

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[25] We believe it unnecessary to undertake any elaborate exposition of the cases in which this Court has discussed this principle. For the convenience of the Court we have set out several extracts from the leading cases in Appendix A, *infra*, pp. 51–56.

[26] *In re 620 Church St. Bldg. Corp.*, 299 U. S. 24; *In re Witherbee Court Corp.*, 88 F. (2d) 251 (C. C. A. 2d), cert. den., 301 U. S. 701; *In re Barclay Park Corp.*, 90 F. (2d) 595 (C. C. A. 2d); *In re Day & Meyer, Murray & Young, Inc.*, 93 F. (2d) 657 (C. C. A. 2d); *In re Philadelphia & Reading Coal & Iron Co., Appeal of Schrager* (C. C. A. 3d) 105 F. (2d) 357; *Price* v. *Spokane Silver & Lead Co.*, 97 F. (2d) 237 (C. C. A. 8th), cert. den., 305 U. S. 626 (1938); *Sophian* v. *Congress Realty Co.*, 98 F. (2d) 499 (C. C. A. 8th); *Tellier* v. *Franks Laundry Co.*, 101 F. (2d) 561 (C. C. A. 8th); *In re Dutch Woodcraft Shops*, 14 F. Supp. 467 (W. D. Mich.).

[27] Spaeth and Winks, *The Boyd Case and Section 77*, 32 Ill. L. Rev. 769 (1938); Foster, *Conflicting Ideals for Reorganization*, 44 Yale L. J. 923 (1935); Bonbright and

This was the rule in reorganizations effected through federal equity receivership, the procedure commonly utilized by corporations before the enactment, in 1933 and 1934, of Sections 77 and 77B of the Bankruptcy Act. We submit that it is also the test of whether a plan is "fair and equitable" in reorganizations under the Bankruptcy Act.

In the consideration of plans of reorganization in equity receiverships prior to the enactment of Sections 77 and 77B, the doctrine of the *Boyd* case had frequently been expressed in the phrase "fair and equitable." The phrase had become a term of art in the law of equity reorganizations, employed to indicate that a plan met the requisite standards of fairness. *Jameson* v. *Guaranty Trust Co.*, 20 F. (2d) 808, 815 (C. C. A. 7th) ("equitable and fair"), certiorari denied, 275 U. S. 569; *Walsh Tie & Timber Co.* v. *St. Louis I. N. & S. R. Co.*, 280 Fed. 38, 44 (C. C. A. 8th), certiorari denied, 260 U. S. 743 (1922) ("fairly and equitably treated").[22]

Bergerman, *Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization*, 28 Col. L. Rev. 127 (1928); Friendly, *Some Comments on the Corporate Reorganization Act*, 48 Harv. L. Rev. 39 (1934); Note, 35 Col. L. Rev. 391, 549 (1935); Douglas and Frank, *Landlords' Claims in Reorganizations* (1933) 42 Yale L. Jour. 1003, 1009 *et seq.*; Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization* (1933) 19 Va. L. Rev. 541.

[22] Additional citations are collected in Spaeth and Winks, *op. cit. supra* at 779, n. 44. Similarly, this Court employed the phrase "fair and binding" as the standard to which a

The phrase "fair and equitable" was incorporated into Sections 77 and 77B and made a condition of confirmation of any reorganization plan under these sections.[29] Under a familiar canon of construction, the incorporation in a statute of a phrase which has acquired a fixed meaning through judicial interpretation demands that the phrase be read as understood by the courts.[30] And this Court has recognized that terms used in Section 77B are to be given the meaning they have acquired in the prior equity reorganization practice.[31]

Other provisions of Sections 77 and 77B corroborate the Congressional intention to incorporate the rule of absolute priority as an integral element in their operation. While these statutes generally require the assent of two-thirds of each class of creditors and a majority of each class of stock, as a condition to confirmation of any plan, all participation by stockholders may be eliminated and

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plan must conform. *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445, 452.

[29] Sec. 77 (e) (1), 11 U. S. C. 205 (e) (1); Sec. 77B (f) (1), 11 U. S. C. 207 (f) (1). The words "fair and" were added to Section 77 by amendment in 1935 (Aug. 27, 1935, c. 774, 49 Stat. 911, 918). The same test is retained in chapter X of the Bankruptcy Act, Secs. 174, 221 (2); 11 U. S. C. 574, 621 (2).

[30] *Standard Oil Co.* v. *United States*, 221 U. S. 1, 59; *Kepner* v. *United States*, 195 U. S. 100, 124.

[31] *Duparquet Huot & Moneuse Co.* v. *Evans*, 297 U. S. 216. And in *In re Central Funding Corporation*, 75 F. (2d) 256, 259 (C. C. A. 2d), a "reorganization" under Sec. 77B was defined by reference to prior equity definitions.

their assent is unnecessary if the debtor is shown to be insolvent[32]. Similarly, junior creditors need receive no participation under a reorganization plan, and their assent is unnecessary if no value exists for their interests.[33] The validity of such elimination has been recognized by this Court in its recent decision in *In re 620 Church Street Building Corporation,* 299 U. S. 24. In sustaining a plan which excluded junior-lien creditors, as well as stockholders, this Court said (at p. 27):

> * * * Petitioners insist that their consent to the plan of reorganization was necessary or that their claims should have been accorded "adequate protection." But the adequate protection to which the statute refers is "for the realization of the value of the interests, claims, or liens" affected. Here the controlling finding is not only that there was no equity in the property above the first mortgage but that petitioners' claims were appraised by the court at having "no value." There was no value to be protected. * * *

The principle of the *Boyd* case is thus embedded in the law of reorganizations under sections 77 and

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[32] Sec. 77 (e), 11 U. S. C. 205 (e); Sec. 77B (b) (4), (e) (1), 11 U. S. C. 207 (b) (4), (e) (1). The comparable provisions of chapter X are in Sections 179, 216 (8), 11 U. S. C. 579, 616 (8). The relevant portions of these provisions are set forth in Appendix B, *infra*, pp. 57–74.

[33] Sec. 77 (e), 11 U. S. C. 205 (e); Sec. 77B (b) (5), (e) (1), 11 U. S. C. 207 (b) (5), (e) (1). In chapter X: Sections 179, 216 (7), 11 U. S. C. 579, 616 (7).

77B by virtue both of the legislative intent evident in those sections and their judicial interpretation by this Court. Nevertheless, conflicting decisions among the lower federal courts, hereinafter discussed, have engendered a confusion which we submit should be resolved.

II

A PLAN WHICH IS UNFAIR AS A MATTER OF LAW CANNOT BE MADE VALID BY THE CONSENT OF THE PERCENTAGE OF A CLASS OF SECURITY HOLDERS REQUIRED FOR CONFIRMATION OF A PLAN

The petitioners in this case are dissenting bondholders, who under the plan are required as a class to surrender to stockholders 23% of the value of the enterprise, notwithstanding the fact that the debtor is insolvent and that the total value of the enterprise was found by the District Court to be less than one-third of the principal amount of the bonds outstanding. We have shown under Point I that the doctrine of the *Boyd* case clearly precludes such treatment of senior creditors in equity reorganizations, and in reorganizations under the Bankruptcy Act, in the absence of a contribution from such junior interests as are permitted participation. However, it has been argued that in reorganizations under Sections 77 and 77B the consent of two-thirds of the senior security holders to a plan which gives to their class less than fully compensatory treatment is binding upon the dissenting minority, though the plan provides partic-

ipation for junior classes for which there is no value.[34] Some of the lower federal courts have expressed this view in dicta [35] and decisions.[36]

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[34] This argument assumes such a plan is fair despite this Court's decision in *In re 620 Church St. Bldg. Corp.*, 299 U. S. 24, which, as we have said, recognized the application of the *Boyd* case principle to the reorganization statutes. Those who advance this argument seek to distinguish the *620 Church St. Bldg. Corp.* case, in our view unsuccessfully, on the ground that in that case the majority of creditors accepted a plan which *excluded*, rather than *included* valueless junior interests.

[35] *Downtown Investment Association* v. *Boston Metropolitan Buildings, Inc.*, 81 F. (2d) 314, 323–4 (C. C. A. 1st). The following statement in this opinion was quoted with approval by the District Court in the present case (R. 218):

"* * * A plan of reorganization when accepted is nothing more than an agreement between the debtor and its creditors and stockholders, or if the debtor has been declared insolvent, then between the several classes of creditors. When such contract or agreement has been accepted by the requisite majority of creditors and stockholders, the principle long recognized in composition cases steps in and under the supervision of the court imposes upon objecting minorities the will of the majority. This could not be accomplished under the acid tests applied to equity receiverships before the passage of 77B.

"We therefore hold that section 77B does not require that every plan approved as fair and equitable shall be of such character that it would withstand attack by non-assenting creditors asserting their strict legal rights unaffected by any principles of the Bankruptcy Act."

See also *In re Peyton Realty Co.*, 18 F. Supp. 822 (E. D. Pa.). *Cf. In re Burns Bros.*, 14 F. Supp. 910 (S. D. N. Y.).

[36] Despite a finding or assumption of insolvency, some courts have permitted stockholders to participate without requiring a new contribution. *In re A. C. Hotel Co.*, 93 F. (2d) 841 (C. C. A. 7th); *J. S. Farlee & Co.* v. *Springfield-*

We submit that the doctrine of the *Boyd* case operates to make such a plan no less unfair and inequitable in reorganizations under Sections 77 and 77B than it would have been in an equity receivership. The statute requires *both* that two-thirds of each class of creditors approve and that the plan be "fair and equitable." The former requirement is not a substitute for the basic requirement of fairness.[37]

This position has been adopted by the Circuit Court of Appeals for the Second Circuit in *In re Day & Meyer, Murray & Young*, 93 F. (2d) 657

South Main Realty Co., 86 F. (2d) 931 (C. C. A. 1st); *In re Celotex Co.*, 12 F. Supp. 1 (Del.); *In re United Railways & Electric Co.*, 11 F. Supp. 717 (Md.); *In re Syndicate Oil Corp.*, C. C. H. Bankr. Serv. (1936 ed.), par. 4155. See also *In re Middle West Untilities Co.*, C. C. H. Bankr. Serv. (1936 ed.), par. 3671. *Cf. In re Tharp Ice Cream Co.*, 25 F. Supp. 417 (E. D. Pa.).

Other courts have countenanced such participation apparently without making or demanding a finding of solvency. See *In re 333 North Michigan Ave. Bldg. Corp.*, 84 F. (2d) 936 (C. C. A. 7th), cert. denied, 299 U. S. 602; *In re Georgian Hotel Corp.*, 82 F. (2d) 917 (C. C. A. 7th), cert. denied, 298 U. S. 673; *In re Clark & Willow Streets Corp.*, 21 F. Supp. 43 (E. D. N. Y.).

[37] It is significant in the present case that the District Court, while seemingly regarding the *Boyd* doctrine as controlling (R. —), quoted with approval a case in support of the contrary view (R. 216–218), *supra* note 35. But while the District Court did not rest strongly on the latter ground, this Court is of course free to rest its opinion on any ground, whether or not advanced below. *Ridings* v. *Johnson*, 128 U. S. 212, 218. For this reason we discuss the validity of both views above-mentioned.

(C. C. A. 2d), where the court, facing the precise issue, stated (at 658-659):

> Such a plan does not preserve priorities. See *Northern Pacific Ry. Co.* v. *Boyd*. * * * It is the duty of the court to scrutinize the plans of reorganization proposed for insolvent companies to make certain that the assets belonging to creditors are not by indirection diverted to stockholders. * * * The fact that a large majority of the bondholders approved the plan is of no avail to sustain it.

The same view had been taken earlier by that court in *In re Barclay Park Corp.*, 90 F. (2d) 595 (C. C. A. 2d). In that case, dissenting bondholders protested against participation by stockholders for whom there was no equity. Despite the consent of more than three-fourths of the bondholders, the court reversed the order confirming the plan, saying (at pp. 597, 598):

> * * * we see no justification for canceling large amounts of interest on the claims of either the secured or the general creditors and giving common stock to persons who had no interest left in the enterprise. It was to prefer the stockholders at the expense of the creditors. * * * To justify a retention of a stock interest by the present shareholders it should appear that they have furnished an additional consideration or have an equity in the estate of the debtor after the rights of the creditors are fully provided for in some way.

The proposition was forcefully restated by the Circuit Court of Appeals for the Third Circuit in *In re Philadelphia & Reading Coal & Iron Co., Appeal of Schrager*, 105 F. (2d) 357:

> * * * A plan of reorganization of an insolvent debtor may not over the objection of a single creditor be approved as fair and equitable if it diverts to the stockholders any of the assets which by reason of the insolvency of the debtor belong solely to the creditors. *In re 620 Church Street Corporation*, 299 U. S. 24 * * *; *In re Barclay Park Corporation* * * *, 90 F. (2d) 595; *In re Day & Meyer, Murray and Young* * * * 93 F. (2d) 657; *Price* v. *Spokane Silver and Lead Co.* * * *, 97 F. (2d) 237; *Sophian* v. *Congress Realty Co.* * * *, 98 F. (2d) 499 * * *.[28]

As these courts have recognized, the consent of two-thirds of the class may bind a dissenting minority under Section 77B to a plan that is fair and equitable in law; but that consent is not the test of whether the plan is fair and equitable. If it is not fair and equitable by the criterion of the *Boyd* rule, as we submit is the case here, it cannot be approved by the court, despite the vote of the required majority. This Court, in disposing of a similar point in an equity case, characterized as "mistaken" the "* * * belief that it was the duty of the court to

[28] Also in accord are *Tellier* v. *Franks' Laundry Co.*, 101 F. (2d) 561 (C. C. A. 8th) and *In re Dutch Woodcraft Shops*, 14 F. Supp. 467 (W. D. Mich.).

aid in effectuating the Plan of Reorganization, since a very large majority of the debenture holders had assented to it.'"[39] And at the last term, this Court accepted the proposition as equally applicable to cases under Section 77B. *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307. In that case the Court reversed the order and decision of the lower courts which approved a plan of reorganization. The Court did so on the ground that the plan, and a claim compromise which was an integral part thereof, were unfair, despite the acceptance of the plan and the compromise by the requisite percentages of security holders.

The confusion of thought on this issue has been engendered by the use in the reorganization statutes of the device of compositions; that is, the device whereby a proposal becomes effective without the unanimous assent of creditors, upon agreement by a stated percentage of them. It is in this sense that the term has been used as descriptive of the procedure provided for by Sections 77 and 77B, generally in the consideration of the constitutionality of the device.[40] This has been emphasized by the

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[39] *First National Bank* v. *Flershem*, 290 U. S. 504, 525.

[40] In the same sense this Court has said: "a plan of reorganization * * * cannot be distinguished in principle from the composition with creditors * * *." *Continental Ill. Natl. Bank & Trust Co.* v. *Chicago R. I. & Pac. Ry. Co.*, 294 U. S. 648, 672. "The principle of composi-

statement of this Court in *Callaghan* v. *Reconstruction Finance Corporation*, 297 U. S. 464, at 470:

> Reorganizations now permitted under section 77B present certain resemblances to compositions under section 12 which have been commented upon as *supporting the constitutionality* of the reorganization provisions of section 77 or section 77B. * * * But section 77B contemplates a procedure and results not permissible under section 12. Reorganizations are nowhere referred to in the statute as compositions. [Italics supplied.]

The usefulness of the composition device lies in facilitating the mechanics of corporate reorganizations.[41] The innovation was merely procedural. But the test for judging the propriety of

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tion was first applied to the interest of secured creditors in their security, by § 74 * * *; by § 75 * * *; by § 77 * * *; by § 77B * * *." *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, 586n. 15. Similar expressions appear in *Adair* v. *Bank of America Natl. Trust & Sav. Assn.*, 303 U. S. 350; *United States* v. *Bekins*, 304 U. S. 27.

[41] Senate Report No. 1916, 75th Cong., 3d Sess. (on H. R. 8046, which revised and amended section 77B): "The most important contribution of section 77B to the development of the law was its adaptation of the *device* of bankruptcy compositions to the reorganization of large corporate enterprises. The constitutionality thereof is now well established, and the extent of its use has made it the basic procedure for the reorganization of corporations" (at 19). (Italics added.)

plans remains, as required by the statutes, the "fair and equitable" standard.[42]

No support for a contrary view can be found in the legislative background of Sections 77 and 77B. In enacting Section 77B, the Congress acted upon the assumption that that section substantially embodied the principles of Section 77, the earlier rail-

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[42] Proposals of the type sanctioned under the former composition sections of the Bankruptcy Act are no guide to what is "fair and equitable," for the approval of compositions under section 12 of the Bankruptcy Act was not conditioned on that test. Instead Section 12 (d) provided that "The judge shall confirm a composition if satisfied that (1) it is for the best interests of the creditors * * *." At least one court addressed itself as follows to this specific point in a Section 77B case: "A misconception of the fundamental purposes of the section here invoked appears in the record of proceedings before the special master. Early in these proceedings counsel for the debtor announced the view that the essential purpose of section 77B is to allow the debtor corporation to work out a plan so that creditors will receive approximately what they would obtain in bankruptcy proceedings and still allow the company to continue to function. This view cannot be sustained. * * * The preservation of business enterprises must not be at the expense of creditors, and the provisions of section 77B should not be taken advantage of to effect what, in fact, amounts to a composition under section 12 (11 U. S. C. A. § 30)." *In re Dutch Woodcraft Shops*, 14 F. Supp. 467, at 469 (W. D. Mich.).

Moreover, the general structure of the reorganization sections is inconsistent with the composition theory. Those sections require the submission of plans of reorganization submitted for acceptance by the security holders who participate therein. But the plan need not be submitted for acceptance by stockholders when the debtor is insolvent, or by junior creditors when their interests in the property are valueless. Sec. 77B (b) (4), (5), (e) (1), 11 U. S. C. 207 (b) (4), (5), (e) (1); Sec. 77 (e), 11 U. S. C. 205 (e); *In re 620*

road reorganization section."[43] The history of Section 77 discloses that Congress did not intend to curtail existing rights of creditors. A revision of the existing theory of priority rights would have gone to the very heart of the reorganization scheme. In view of the extended debate provoked by the far less serious procedural changes, an intention drastically to change and curtail these basic rights, with the result that constitutional bounds might possibly have been exceeded,[44] should at least have found unequivocal expression. No such expression is to be found.[45] To the contrary, both statutes require

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Church St. Bldg. Corp., 299 U. S. 24. Consequently, if valueless interests are offered participation pursuant to a composition theory, there is, in contrast with a fundamental purpose of the statutes, no mandatory machinery whereby they vote on the plan. This to be compared with the usual bankruptcy composition, where the offer may be made only by the debtor, and a composition to which the debtor is opposed cannot be consummated. Bankruptcy Act Sec. 12 (prior to 1938 amendment; 11 U. S. C. 30; chapter XI, 11 U. S. C. Sec. 701 *et seq.*

[43] "The scheme of this section is similar to that of section 77 of Chapter VIII entitled 'Reorganization of Railroads Engaged in Interstate Commerce,'" House Report No. 194, 73rd Cong., 1st Sess., on H. R. 5884, the bill which became Public, No. 296, 73rd Cong., and which contained Section 77B at p. 2. The Senate Committee adopted the House Report. Sen. Rep. No. 7482 on H. R. 5884, 73rd Cong., 2d Sess.

[44] Cf. Dodd, *Reorganization through Bankruptcy; a Remedy for what?* (1935) 48 Harv. L. Rev. 1100; *In re New York, N. H. & H. R. R. Co.*, 16 F. Supp. 504, 509. (Conn.).

[45] Representative Rayburn declared that it "will better protect bondholders and other preferred claimants in their rights than has been customary in receiverships." 76 Cong.

that the plan be "fair and equitable," a phrase whose content was definite and understood.

Finally, any theory which rests the "fairness" of a plan on the fact that it has won the approval of the requisite percentage of the security holders destroys the function which, plainly, the district court was meant to perform. If the consents of a majority, frequently illusory in nature,[46] are to

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Rec. 2918 (1933). That it was not intended to give the stockholders a more favorable position than they occupied under the *Boyd* case doctrine may be also inferred from the remark of Representative LaGuardia, a member of the Committee which reported the bill: "If the railroad is found to be insolvent * * * then stockholders are wiped out * * *." (*Id.* 2924.)

There are Congressional statements which analogize the reorganization sections to the old composition sections of the Act. Rep. Sumners, 76 Cong. Rec. 2908; Rep. Condon, *id.* 2913–14; Rep. Michener, *id.* 2928; Rep. McKeown, *id.* 2931 (1933). A memorandum by the Solicitor General contained comparable language (quoted in 76 Cong. Rec. 2771). It becomes apparent upon examination that these general references to principles of composition were not intended to sanction the impairmant of creditors' rights, but rather to describe and sanction the use in reorganizations of the *device* of composition, whereby the acceptance of a fair plan by a majority binds the minority to acceptance also. This did not, as we have said, trench on the criteria by which the fairness of the plan is to be judged.

[46] The Senate, in its report on chapter X of the amended Bankruptcy Act, revising Section 77B, stated: "*. * * Individual creditors fail to receive adequate information concerning either the debtor or the plans for its reorganization, and therefore lack the information upon which

control in every case, the determination by the court is at best a futile formality; there can never be any effective independent estimate of the fairness of a plan,[17] nor any effective standards of fairness. Nor would the scrutiny of the plan by the court serve any purpose after the vote, except to "rub-

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to base proposals of their own or upon which to determine whether to accept the proposals of others.

"The conditions imposed in section 77B upon the proposal of plans have rendered investor participation in the proposal of plans extremely difficult; as a result, creditors and stockholders, unable to take individual action in their own behalf and unable to attempt joint action because of difficulties in the way of obtaining other bondholders' and creditors' names and addresses, are in the main forced to depend upon self-constituted protective committees. *These committees, and others in similar roles, are able to present plans to the court under section 77B which have the ostensible, though not real, support of creditors and stockholders.* The courts are subjected thereby to an indefensible pressure to approve such plans, without giving to them the free and independent scrutiny which in theory the law requires. * * *" Senate Report No. 1916, 75th Cong., 3d Sess., at 22 (1938). (Italics supplied.)

[17] Yet under Section 77(d) and (e) the Interstate Commerce Commission must approve a plan *before* it is certified to the court, and *before* creditors and stockholders vote upon it. The Securities and Exchange Commission has a similar duty under the Public Utility Holding Company Act of 1935 for companies subject to that Act which are reorganized in the federal courts. Sec. 11(f); 15 U. S. C. 79K(f). And under chapter X of the amendatory Bankruptcy Act, revising Section 77B, the judge is required to consider and approve plans before creditors and stockholders are asked to vote upon it. Secs. 174–176, 11 U. S. C. 574–576.

ber stamp" the ostensible wishes of the creditors and stockholders."

We submit that the statute plainly contemplates that there shall be independent standards of fairness by which plans of reorganization may be judged and that there shall be an independent judicial appraisal of the fairness of the plan according to such standards. The conflict of opinion among the lower federal courts as to the correctness of this view emphasizes the need that the issue now be resolved by this Court.

III

THE ALLEGED "CONSIDERATION" TO BE FURNISHED BY THE STOCKHOLDERS DOES NOT SUPPORT THEIR PARTICIPATION UNDER THE PLAN

In the development of the *Boyd* doctrine, it has been recognized that there is one situation in which it may be proper to permit junior interests, having no value or equity in the debtor's assets, to participate in the reorganization. That is the case in which, in accordance with provisions in the plan, junior interests furnish a contribution for the privilege of retaining an interest in the reorganization. Unless this practice is limited, however, to cases where the contribution is either in money or in money's worth reasonably equivalent to the

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" But this Court said, in an equity reorganization case: "Every important determination by the court in receivership proceedings calls for an informed, independent judgment." *National Surety Co.* v. *Coriell*, 289 U. S. 426, 436.

participation afforded, the *Boyd* rule is violated by the diversion of values to the junior interests.

This Court has had occasion to sanction the practice, even as so limited, only in equity reorganizations, where it was at times necessary to raise funds in order to pay dissenting bondholders, or to provide the enterprise with new capital. It was believed that new investors could not be interested and that existing stockholders constituted the only available source of funds. It was assumed that they could be induced to contribute in the hope of salvaging a portion of their previous investment. This Court recognized the problem in both the *Boyd* and *Kansas City Terminal* cases. In the latter the Court said (271 U. S. 445, 455–6):

> Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. * * *
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> * * * No offer is fair which does not recognize the prior rights of creditors, as above pointed out; but circumstances may justify an offer of different amounts of the same grade of securities to both creditors and stockholders. Whenever assessments are demanded, they must be adjusted with the purpose of according to the creditor his full right of priority against the corporate assets, so far as possible in the existing circumstances.

In short, under the decisions of this Court valueless junior interests may be permitted to contribute and participate where: (a) new funds are essential; (b) the new funds cannot be obtained unless stockholders are permitted to contribute and retain an interest; and (c) the priorities of the creditors are protected to the fullest possible extent.

This rule of contribution has been deemed applicable to the reorganization statutes. For example, in *In re Dutch Woodcraft Shops*, 14 F. Supp. 467, 471 (W. D. Mich.), the court stated:

> Circumstances may exist where the success of an undertaking requires that new money be furnished and where the former stockholders are the only or most feasible source of new capital. In such instances, the Court may recognize as fair and equitable a plan which includes contributions of new money by stockholders, provided it satisfactorily appears that full recognition has been given to the value of creditors' claims against the property."

Representatives of valueless interests, however, have been alive to the possibility of circumventing the *Boyd* case doctrine and diverting to themselves values belonging to senior claimants by paying less.

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[49] Another case in accord is *In re Witherbee Court Corp.*, C. C. H. Bankr. Law Serv. (1936 ed.) par. 3727 (S. D. N. Y.).

than the fair equivalent for what they receive. In equity receiverships, the attempt was generally in terms of a demand for an excessive amount of securities for the cash paid. In reorganizations under the Bankruptcy Act, efforts to misapply the rule of contribution have taken a somewhat different form. The attempt now is to justify participation for these interests, not upon the basis of a cash contribution or even its equivalent, but upon the basis of "considerations" which are at best technical and at times wholly specious. The present case is but one such instance.

The District Court rested its determination that the stockholders' participation was authorized on findings which were substantially as follows:

(1) It will be an asset of value to the new company to retain the present Class A stockholders as stockholders because of their familiarity with the business, and because of their financial standing and influence in the community (R. 321);

(2) The principal valuable consideration passing between the bondholders and the stockholders is the virtual abrogation of the 1930 agreement deferring foreclosure until 1944 (R. 321–322); and

(3) The value to the bondholders of maintaining the Debtor as a going concern, and of avoiding litigation, exceeds the value of the stock being issued to the Class A shareholders (R. 323).

1. The first of these findings was apparently regarded as sufficient to support a conclusion of fairness and equity on the assumption that it was necessary to permit junior securities to retain stock in order to provide continuity of the existing management. Such an assumption rests in turn upon a confusion of management with stock ownership. Legally the two are separate and distinct.[50] And in practice there is ordinarily no necessary identity between granting stockholders participation and retaining or obtaining desirable management.

It is by no means axiomatic that the management of a corporation at the time of reorganization should be retained. On the contrary, the proceedings may bring to light facts showing that the retention of that management is not in the best interests of the corporation. As the circumstances in this case make plain, the problem of providing the reorganized company with a sound management should properly be considered as a question separate and distinct from that of the right of a class of security holders to participate in the plan. Situations may arise where a commitment to provide desired management can be procured only by the issuance of stock to the persons whose services are sought. This is a far cry, however, from the facts offered to justify stockholder participation in the instant case.

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[50] Berle and Means, *The Modern Corporation and Private Property* (1932), Chs. IV, V, VI.

Value is found here simply in the fact that the present stockholders are familiar with the business and have financial standing and influence in the community. Mention was also made in the District Court's opinion of business contacts (R. 227). But no management contract has been entered into here, and the stockholders have not committed themselves to use their influence, standing, or contacts in the interests of the corporation.

Certainly the continuation in office of members of the management who own no stock will not be insured by this method. Conversely, not all of the Class A stockholders are a part of the management (R. 84-5). Plainly, those who are not will have furnished no consideration if, in order to retain the few stockholders who constitute the management, stock is given to all.

This indiscriminate distribution of stock does not even insure retention of the services of those stockholders who are a part of the management. There is no finding that it would. To be sure, the members of the management have "expressed a willingness" to assume managerial responsibility, but they are not bound to do so (R. 227). There is nothing to prevent them from selling their stock, realizing their share of the 23% allotted to stockholders, and abandoning the enterprise. Such a possibility is by no means fanciful. The record indicates that the members of the management are unwilling to continue unless they can finance larger

building operations (R. 197). But a program of construction instead of repair requires rehabilitation of the plant, and it would cost $150,000 to put only one of the four building ways into first class condition (R. 71). The plan does not disclose the manner in which funds are to be raised.[51] If, as is possible, the funds are not raised, the managers may abandon the enterprise, and the stock allocation will have failed to insure continuity of present management.

If the rule requiring preservation of contract priorities is not to become a nullity, the allotment of stock as a consideration for managerial services should be limited to those who are to perform the services. And performance of the expected service should be removed from the realm of unfortified hope and made certain. The mere *possibility* that *some* of the stockholders may continue to furnish managerial services cannot, as a matter of law, be fair payment for the participation of the entire class of stockholders in the new corporation. Nor can such vague intangibles as business contacts, or the financial standing and influence of the stockholders in the community, without more, provide a

[51] If the funds are raised, it is not unlikely that the persons who contribute them will have something to say about the management. If they have confidence in the present management, they may insist that its continuation be insured by employment contracts, in which case the allotment of stock to the managers is unnecessary. On the other hand, they may install their own management, in which case allotment of stock to the present managers will have been futile.

basis for the issuance of stock to them. Securities should be issued only to the extent that they represent a fair payment for a definite undertaking, valuable to the reorganized enterprise.

We are sustained in this position by *In re Barclay Park Corp.*, 90 F. (2d) 595, 598 (C. C. A. 2d), which declared:

> It is argued that the stockholders represent the present management of the hotel and that the management is valuable and indeed necessary to the enterprise and that the manager-stockholders will "walk out" if the proposed plan does not go through and leave the hotel to its fate. But there is no binding agreement on their part to remain which might afford a justification for giving them a stock interest and, if their managerial skill is vital to the success of the hotel, any stock issued to insure the continuance of their relation ought to go to those stockholders who are of use to the enterprise and agree to act in its behalf, and not to all stockholders as such.

2. The second finding of the District Court relates to the alleged surrender by stockholders of a right, by reason of the terms of the 1930 agreement, to defer foreclosure of the mortgage securing the bonds until 1944.

There was, however, no such right once the petition for reorganization, voluntarily filed by the stockholders through their control of the debtor (R. 77, 79, 101), was approved. In instituting the

reorganization proceeding, the Debtor and the stockholders accepted all the consequences which might flow from the reorganization, including the confirmation of a plan which eliminated their interests. After approval of the petition, they were powerless to withdraw merely because the requirements of a fair plan precluded their participation. Voluntary reorganization proceedings have not infrequently ended with plans excluding stockholders.[32] This necessarily follows where it is found that they have no equity and have made no fresh contribution in money or in money's worth. No such contribution can be found in the surrender of a right already waived.

In any event no such right could exist once it was determined that the value of the enterprise was less than the creditors' claims. Under the absolute priority doctrine the assets thereafter belonged to the creditors. The stockholders had no interest in the estate upon the basis of which they could assert any rights adverse to the claims of the bondholders.

The District Court's contrary conclusion resulted from its erroneous assumption that if the Debtor's plan was not confirmed, the proceeding would have to be dismissed, restoring the stockholders' rights under the indenture (R. 227, 238). But dismissal was by no means the only alternative to approval of the plan. There was no showing

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[32] E. g., *In re Reading Hotel Corp.*, 89 F. (2d) 53 (C. C. A. 3d), certiorari denied, 302 U. S. 742.

that a fair, feasible, and proper plan, complying with the statute in all respects, and confining participation to the bondholders, could not be adopted. Consequently the Court could properly refuse to surrender jurisdiction. *Matter of Bush Terminal Co.*, 84 F. (2d) 984 (C. C. A. 2d), certiorari denied, 299 U. S. 596.

3. The District Court, in its third finding, assumed that the issuance of stock to the Class A stockholders was justified as a means of avoiding litigation with them. Their position, in essence, was that it was proper to buy them off though their interests were concededly worthless. There is no reason why courts should bow before such threats. Holders of clearly valueless interests should not be permitted to enforce their demands by threats of extended controversy. The court was required by the statute to find whether the plan was "fair and equitable." This means that it was to resist, not to reinforce, claims based upon nuisance value.

The third finding of the District Court also recites that the value to the bondholders of maintaining the Debtor as a going concern, and of avoiding litigation, exceeds the value of the stock allotted to the Class A stockholders. But since, as we have pointed out, these did not constitute a valid contribution, determination of their value is irrelevant.

The test of the adequacy of contributions to sustain participation of valueless interests in a fair plan is not one of technical consideration in the

contract sense. Whether stockholders for whom there is no equity may participate in the reorganized corporation must depend upon whether they pay a fair equivalent for what they are to receive. Without such a test, evasions of the absolute priority doctrine are likely to become the settled course of reorganization procedure.

CONCLUSION

For the reasons stated above, we submit that the plan of reorganization involved in these cases is not "fair and equitable," and that the decision of the court below approving confirmation of the plan should be reversed.

Respectfully submitted.

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OCTOBER, 1939.

APPENDIX A

Leading Decisions of this Court on the Absolute Priority Doctrine

The decisions of this Court on the absolute priority rule begin with *Railroad Co.* v. *Howard*, 7 Wall. 392. The principle on which that case rests was articulated in *Louisville Trust Co.* v. *Louisville, Albany & Chicago Ry. Co.*, 174 U. S. 674, the famous "Monon" case. Without reviewing the facts of the latter case at length, it is sufficient to say that they involved an attack by an unsecured creditor on a decree of foreclosure and sale of a railroad mortgage, on the ground that the mortgage had been foreclosed by agreement between mortgage bondholders and stockholders for the purpose of eliminating the rights of unsecured creditors. This Court said, by Mr. Justice Brewer (p. 683):

> We do not stop to inquire, because the question is not presented by this record, whether a court is justified in permitting a foreclosure and sale which leaves any interest in the mortgagor, to wit, the railroad company and its stockholders, and ought not always to require an extinction of all the mortgagor's interest and a full transfer to the mortgagee, representing the bondholders. Assuming that foreclosure proceedings may be carried on to some extent at least in the interests and for the benefit of both mort-

> gagee and mortgagor, (that is, bondholder and stockholder (we observe that no such proceedings can be rightfully carried to consummation which recognize and preserve any interest in the stockholders without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation. In other words, if the bondholder wishes to foreclose and exclude inferior lienholders or general unsecured creditors and stockholders he may do so, but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and preserve the prior rights of general creditors thereof. This is based upon the familiar rule that the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors. And any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation.

The famous case of *Northern Pacific Ry. Co.* v. *Boyd,* 228 U. S. 482 involved the same issue. The Court there said, by Mr. Justice Lamar (pp. 504, 507–8):

> Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred before the creditor was invalid. * * * The invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, for in cases like this, the question must be decided according to a fixed principle, not leaving the rights of the creditors to depend upon the

balancing of evidence as to whether, on the day of sale the property was insufficient to pay prior encumbrances. * * * If the value of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value whether it was present or prospective, for dividends or only for purposes of control. In either event it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever.

This conclusion does not, as claimed, require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock.

In *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445 the Court applied these principles to answer three questions certified by the Circuit Court of Appeals for the Eighth Circuit, as follows (pp. 452–453):

I. Is a plan of reorganization of a railway company sufficient as to unsecured creditors and binding upon them which does not give precedence to the entire claim of the creditor over any part or interest of a stockholder in the old company?

II. Is such a plan fair and binding upon such creditors even though they be offered securities of the same grade as the stockholders, the difference being only in the greater amount offered the creditors, provided the court shall be of the opinion that the offer tenders to such creditors all that

could reasonably be expected under all of the existing circumstances?

III. Is such offer as to such creditors fair and binding if it consists only of the same grade of securities as offered the stockholders, the difference being that the right of the stockholders to participate is conditioned upon the payment of an assessment or the payment of a relatively greater assessment than that asked of such creditors, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?

The Court answered, by Mr. Justice McReynolds (pp. 454–455–456):

* * * when necessary, they [unsecured creditors] may be protected through other arrangements [than payment in cash, income bonds, or preferred stock] which distinctly recognize their equitable right to be preferred to stockholders against the full value of all property belonging to the debtor corporation, and afford each of them fair opportunity, measured by the existing circumstances, to avail himself of this right.

Unsecured creditors of insolvent corporations are entitled to the benefit of the values which remain after lien holders are satisfied, whether this is present or prospective, for dividends or only for purposes of control. But reasonable adjustments should be encouraged. Practically, it is impossible to sell the property of a great railroad for cash; and, generally, the interest of all parties, including the public, are best served by cooperation between bondholders and stockholders. If creditors decline a fair offer based upon the principles above stated,

they are left to protect themselves. After such refusal they cannot attack the reorganization in a court of equity. *Northern Pacific Railway Co.* v. *Boyd*, p. 508.

Question I, if interpreted strictly and according to the ordinary meaning of the words employed, must be answered in the negative. We assume that to "give precedence" implies recognition of superior importance. As above stated, to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation. But it does not follow that in every reorganization the securities offered to general creditors must be superior in rank or grade to any which stockholders may obtain. It is not impossible to accord to the creditor his superior rights in other ways. Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. In such or similar cases the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights.

Question II is answered in the affirmative with the qualifications which follow. The primary right of unsecured creditors to the assets of an insolvent corporation remaining after lien holders are satisfied, must be adequately protected; and to each one of them there must be given such opportunity as the circumstances permit to secure the full enjoyment of this preference.

Question III is also answered in the affirmative, subject to the following qualification. No offer is fair which does not recognize the prior rights of creditors, as above

pointed out; but circumstances may justify an offer of different amounts of the same grade of securities to both creditors and stockholders. Whenever assessments are demanded, they must be adjusted with the purpose of according to the creditor his full right of priority against the corporate assets, so far as possible in the existing circumstances.

APPENDIX B

STATUTORY PROVISIONS

SECTION 77B OF THE BANKRUPTCY ACT OF 1898

(48 Stat. 911 (1934); am'd, 49 Stat. 664 (1935); am'd, 49 Stat. 965 (1935); am'd, 50 Stat. 622 (1937); 11 U. S. C. § 207)

(b) (11 U. S. C. § 207 (b)) A plan of reorganization within the meaning of this section * * *

(4) shall provide in respect of each class of stockholders, of which less than a majority shall accept such plan (unless the judge shall determine either that the debtor is insolvent, or that the interest of such class of stockholders will not be affected adversely by the plan), adequate protection for the realization by them of the value of their equity, if any, in the property of the debtor dealt with by the plan, either, as provided in the plan, (a) by a sale of the property at not less than a fair upset price, or (b) by appraisal and payment in cash of the value either of their stock, or at the objecting stockholders' election, of the securities allotted to such stockholders under the plan, if any shall be so allotted, or (c) by such methods as will do substantial justice to such stockholders under and consistent with the circumstances of the particular case;

(5) shall provide in respect of each class of creditors of which less than two-thirds in amount shall

accept such plan (unless the claims of such class of creditors will not be affected by the plan, or the plan makes provision for the payment of their claims in cash in full), provide adequate protection for the realization by them of the value of their interests, claims, or liens, if the property affected by such interests, claims, or liens is dealt with by the plan, either as provided in the plan (a) by the transfer or sale of such property subject to such interests, claims, or liens, or by the retention of such property by the debtor subject to such interests, claims, or liens, or (b) by a sale free of such interests, claims, or liens at not less than a fair upset price and the transfer of such interests, claims, or liens to the proceeds of such sale; or (c) by appraisal and payment either in cash of the value either of such interests, claims, or liens, or, at the objecting creditors' election, of the securities allotted to such interests, claims, or liens under the plan, if any shall be so allotted; or (d) by such method as will in the opinion of the judge, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

* * * * * *

(d) (11 U. S. C. §207 (d)) A plan of reorganization which has been approved by creditors of the debtor, whose claims would be affected by the plan, being not less than 25 per centum in amount of any class of creditors, and not less than 10 per centum in amount of all the claims against the debtor, or, if the debtor is not found by the judge to be insolvent, but is found unable to meet its debts as they mature, by stockholders whose interests would

be affected by the plan, provided said amount is not less than 10 per centum of any class of stock outstanding and not less than 5 per centum of the total number of shares of all classes of stock outstanding, may be proposed by any creditor or by any stockholder, or without such approval by the debtor, at a hearing duly noticed for its consideration or for the consideration of any other plan of reorganization similarly proposed.

(e) (1) (11 U. S. C. § 207 (e) (1)) A plan of reorganization shall not be confirmed until it has been accepted in writing, whether before or after the filing of the petition or answer under this section, and such acceptance shall have been filed in the proceeding by or on behalf of creditors holding two-thirds in amount of the claims of each class whose claims have been allowed and would be affected by the plan and by or on behalf of stockholders of the debtor holding a majority of the stock of each class: *Provided, however,* That such acceptance shall not be requisite to the confirmation of the plan by any creditor or class of creditors (a) whose claims are not affected by the plan, or (b) if the plan makes provision for the payment of their claims in cash in full, or (c) if provision is made in the plan for the protection of the interests, claims, or liens of such creditor or class of creditors in the manner provided in subdivision (b), clause (5), of this section: *And provided further,* That such acceptance shall not be requisite to the confirmation of the plan by any stockholder or class of stockholders (1) if the judge shall have determined either that the debtor is insolvent, or that the interests of such stockholder or stock-

holders will not be affected by the plan, or (2) if provision is made in the plan for the protection of the interests of such stockholder or class of stockholders in the manner provided in subdivision (b), clause (4), of this section.

* * * * *

(f) (11 U. S. C. § 207 (f)) After hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that (1) it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible; (2) it complies with the provisions of subdivision (b) of this section; (3) it has been accepted as required by the provisions of subdivision (e), clause (1) of this section; * * *

CHAPTER X OF THE BANKRUPTCY ACT OF 1898

(52 Stat. 883 (1938); 11 U. S. C. § 501 *et seq.*)

SEC. 169 (11 U. S. C. § 569). Where a trustee has been appointed the judge shall fix a time within which the trustee shall prepare and file a plan, or a report of his reasons why a plan cannot be effected, and shall fix a subsequent time for a hearing on such plan or report and for the consideration of any objections which may be made or of such amendments or plans as may be proposed by the debtor or by any creditor or stockholder.

SEC. 170 (11 U. S. C. § 570). Where a debtor is continued in possession, a plan or plans may be filed, within a time fixed by the judge—

(1) by the debtor;

(2) by any creditor or indenture trustee;

(3) by any stockholder, if the debtor is not found to be insolvent;

(4) by the examiner, if so directed by the judge. The judge shall fix a subsequent time for a hearing on such plans and for the consideration of any objections or amendments thereto.

* * * * * *

SEC. 172 (11 U. S. C. § 572). After the hearing, as provided in section 169 or section 170 of this Act, and before the approval of any plan, as provided in section 174 of this Act, the judge may, if the scheduled indebtedness of the debtor does not exceed $3,000,000, and shall, if such indebtedness exceeds $3,000,000, submit to the Securities and Exchange Commission for examination and report the plan or plans which the judge regards as worthy of consideration. Such report shall be advisory only.

SEC. 173 (11 U. S. C. § 573). The judge shall not enter an order approving a plan submitted to the Securities and Exchange Commission until after the Securities and Exchange Commission has filed its report thereon or has notified the judge that it will not file a report, or until the expiration of such reasonable time for the filing of such report as the judge has fixed, whichever first occurs.

SEC. 174 (11 U. S. C. § 574). After the hearing, as provided in section 169 or section 170 of this Act, and, if a plan has been submitted to the Securities and Exchange Commission, as provided in section 172 of this Act, then after the filing of the report or notice that it will not be filed, or after the expiration of the time for its filing, whichever first occurs, the judge shall enter an order approving the plan or plans which in his opinion comply

with the provisions of section 216 of this Act, and which are fair and equitable, and feasible, and shall fix a time within which the creditors and stockholders affected thereby may accept the same.

SEC. 175 (11 U. S. C. § 575). Upon the approval of a plan by the judge, the trustee or the debtor in possession shall transmit, by mail or otherwise, to all creditors and stockholders who are affected by any such plan—

(1) the plan or plans so approved, together with a summary thereof approved by the judge;

(2) the opinion of the judge, if any, approving the plan, or plans, or a summary thereof approved by the judge;

(3) the report, if any, filed in the proceeding by the Securities and Exchange Commission, as provided in section 172 of this Act, or a summary thereof prepared by the Securities and Exchange Commission; and

(4) such other matters as the judge may deem necessary or desirable for the information of creditors and stockholders.

SEC. 176 (11 U. S. C. § 576). No person shall, without the consent of the court, solicit any acceptance, conditional or unconditional, of any plan, or any authority, conditional or unconditional, to accept any plan, whether by proxy, deposit, power of attorney or otherwise, until after the entry of an order approving such plan and the transmittal thereof to the creditors and stockholders, as provided in section 175 of this Act; and any such authority or acceptance given, procured, or received by reason of a solicitation prior to such approval

and transmittal shall be invalid, unless such consent of the court has been so obtained.

* * * * *

SEC. 179 (11 U. S. C. § 579). After a plan has been accepted in writing, filed in court, by or on behalf of creditors holding two-thirds in amount of the claims filed and allowed of each class, and, if the debtor has not been found to be insolvent, by or on behalf of stockholders holding the majority of stock, of which proofs have been filed and allowed, of each class, exclusive of creditors or stockholders or of any class of them who are not affected by the plan or whose claims or stock are disqualified pursuant to section 203 of this Act, or for whom payment or protection has been provided as prescribed in paragraphs (7) and (8) of section 216 of this Act, the judge shall fix a hearing, upon notice to the debtor, creditors, stockholders, indenture trustees, the Secretary of the Treasury, the Securities and Exchange Commission, and such other persons as the judge may designate, for the consideration of the confirmation of the plan and of such objections as may be made to the confirmation.

* * * * *

SEC. 208 (11 U. S. C. § 608). The Securities and Exchange Commission shall, if requested by the judge, and may, upon its own motion if approved by the judge, file a notice of its appearance in a proceeding under this chapter. Upon the filing of such notice, the Commission shall be deemed to be a party in interest, with the right to be heard on all matters arising in such proceeding, and shall be deemed to have intervened in respect of all matters

in such proceeding with the same force and effect as if a petition for that purpose had been allowed by the judge; but the Commission may not appeal or file any petition for appeal in any such proceeding.

* * * * * *

Sec. 216 (11 U. S. C. § 616). A plan of reorganization under this chapter—

* * * * * *

(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or (b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

(8) shall provide for any class of stockholders which is affected by the plan and does not accept the plan by the majority of the stock required under this chapter, adequate protection for the realization by them of the value of their equity, if any, in the property of the debtor dealt with by the plan, either as provided in the plan or in the order confirming the plan, (a) by the sale of such property at not

less than a fair upset price; or (b) by appraisal and payment in cash of the value of their stock; or (c) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection: *Provided, however,* That such protection shall not be required if the judge shall determine that the debtor is insolvent;

* * * * * *

SEC. 221 (11 U. S. C. § 621). The judge shall confirm a plan if satisfied that—

* * * * * *

(2) the plan is fair and equitable, and feasible;

* * * * * *

SEC. 276 (U. S. C. § 676) * * *

(c) the provisions of section 77A and 77B of chapter VIII, as amended, of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1898, shall continue in full force and effect with respect to proceedings pending under those sections upon the effective date of this amendatory Act, except that—

(1) if the petition in such proceedings was approved within three months prior to the effective date of this amendatory Act, the provisions of this chapter shall apply in their entirety to such proceedings; and

(2) if the petition in such proceedings was approved more than three months before the effective date of this amendatory Act, the provisions of this chapter shall apply to such proceedings to the extent that the judge shall deem their application practicable; * * *

(47 Stat. 1474 (1933); am'd, 48 Stat. 924 (1934); am'd, 49 Stat. 911 (1935); am'd, 49 Stat. 1969 (1936); 11 U. S. C. § 205)

d. (11 U. S. C. § 205 (d)) TIME FOR FILING PLAN OF REORGANIZATION; HEARINGS BY COMMISSION; CERTIFICATION OF APPROVAL TO COURT.—The debtor, after a petition is filed as provided in subsection a of this section, shall file a plan of reorganization within six months of the entry of the order by the judge approving the petition as properly filed, or if heretofore approved, then within six months of August 27, 1935, and not thereafter unless such time is extended by the judge from time to time for cause shown, no single extension at any one time to be for more than six months. Such plan shall also be filed with the Commission[1] at the same time. Such plans may likewise be filed at any time before, or with the consent of the Commission during, the hearings hereinafter provided for, by the trustee or trustees, or by or on behalf of the creditors being not less than 10 per centum in amount of any class of creditors, or by or on behalf of any class of stockholders being not less than 10 per centum in amount of any such class, or with the consent of the Commission by any party in interest. After the filing of such a plan, the Commission, unless such plan shall be considered by it to be prima facie impracticable, shall, after due notice to all stockholders and creditors given in such manner as it shall determine,

[1] Interstate Commerce Commission. Sec. 77 (a), 11 U. S. C. 205 (a).

hold public hearings, at which opportunity shall be given to any interested party to be heard, and following which the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections b and e of this section, and will be compatible with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions.

The Commission may thereafter, upon petition for good cause shown filed within sixty days of the date of its order, and upon further hearings if the Commission shall deem necessary, in a supplemental report and order modify any plan which it has approved, stating the reasons for such modification. The Commission, if it approves a plan, shall thereupon certify the plan to the court together with a transcript of the proceedings before it and a copy of the report and order approving the plan. No plan shall be approved or confirmed by the judge in any proceeding under this section unless the plan shall have been approved by the Commission and certified to the court.

e. (11 U. S. C. § 205 (e)) COURT HEARING AFTER APPROVAL BY COMMISSION; ACCEPTANCE OF PLAN BY CREDITORS AND STOCKHOLDERS; CONFIRMATION OF PLAN BY COURT; VALUATION OF PROPERTY.—Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and

such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection b of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection c, paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such

payment, and the judge is hereby given power to approve the same.

If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. If the proceedings are referred back to the Commission, it shall proceed to a reconsideration of the proceedings under the provisions of subsection d of this section. If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection c of this section, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: *Provided,* That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value, or

that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, or (b) that the interests of such class of stockholders will not be adversely and materially affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance: *Provided further*, That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. For the purpose of this section the acceptance or rejection by any creditor or stockholder shall be in writing, executed by him or by his duly authorized attorney, committee, or representative. If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation) the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests or claims thereof shall be deemed to be affected by the plan, and the President of the United States, or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation. The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission.

Upon receipt of such certification, the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: *Provided,* That if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection e: * * *

PUBLIC UTILITY ACT OF 1935

(49 Stat. 803 (1935); 15 U. S. C. § 79)

SEC. 11 (15 U. S. C. § 79k). * * * (f) In any proceeding in a court of the United States, whether under this section or otherwise, in which a

receiver or trustee is appointed for any registered holding company, or any subsidiary company thereof, the court may constitute and appoint the Commission [2] as sole trustee or receiver, subject to the directions and orders of the court, whether or not a trustee or receiver shall theretofore have been appointed, and in any such proceeding the court shall not appoint any person other than the Commission as trustee or receiver without notifying the Commission and giving it an opportunity to be heard before making any such appointment. In no proceeding under this section or otherwise shall the Commission be appointed as trustee or receiver without its express consent. In any such proceeding a reorganization plan for a registered holding company or any subsidiary company thereof shall not become effective unless such plan shall have been approved by the Commission after opportunity for hearing prior to its submission to the court. Notwithstanding any other provision of law, any such reorganization plan may be proposed in the first instance by the Commission or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization. The Commission may, by such rules and

[2] Securities and Exchange Commission. Sec. 2 (a) (6), 15 U. S. C. 79b (a) (6).

regulations or order as it may deem necessary or appropriate in the public interest or for the protection of investors or consumers, require that any or all fees, expenses, and remuneration, to whomsoever paid, in connection with any reorganization, dissolution, liquidation, bankruptcy, or receivership of a registered holding company or subsidiary company thereof, in any such proceeding, shall be subject to approval by the Commission.

(g) It shall be unlawful for any person to solicit or permit the use of his or its name to solicit, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, any proxy, consent, authorization, power of attorney, deposit, or dissent in respect of any reorganization plan of a registered holding company or any subsidiary company thereof under this section, or otherwise, or in respect of any plan under this section for the divestment of control, securities, or other assets, or for the dissolution of any registered holding company or any subsidiary company thereof, unless—

(1) the plan has been proposed by the Commission, or the plan and such information regarding it and its sponsors as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers has been submitted to the Commission by a person having a bona fide interest (as defined by the rules and regulations of the Commission) in such reorganization;

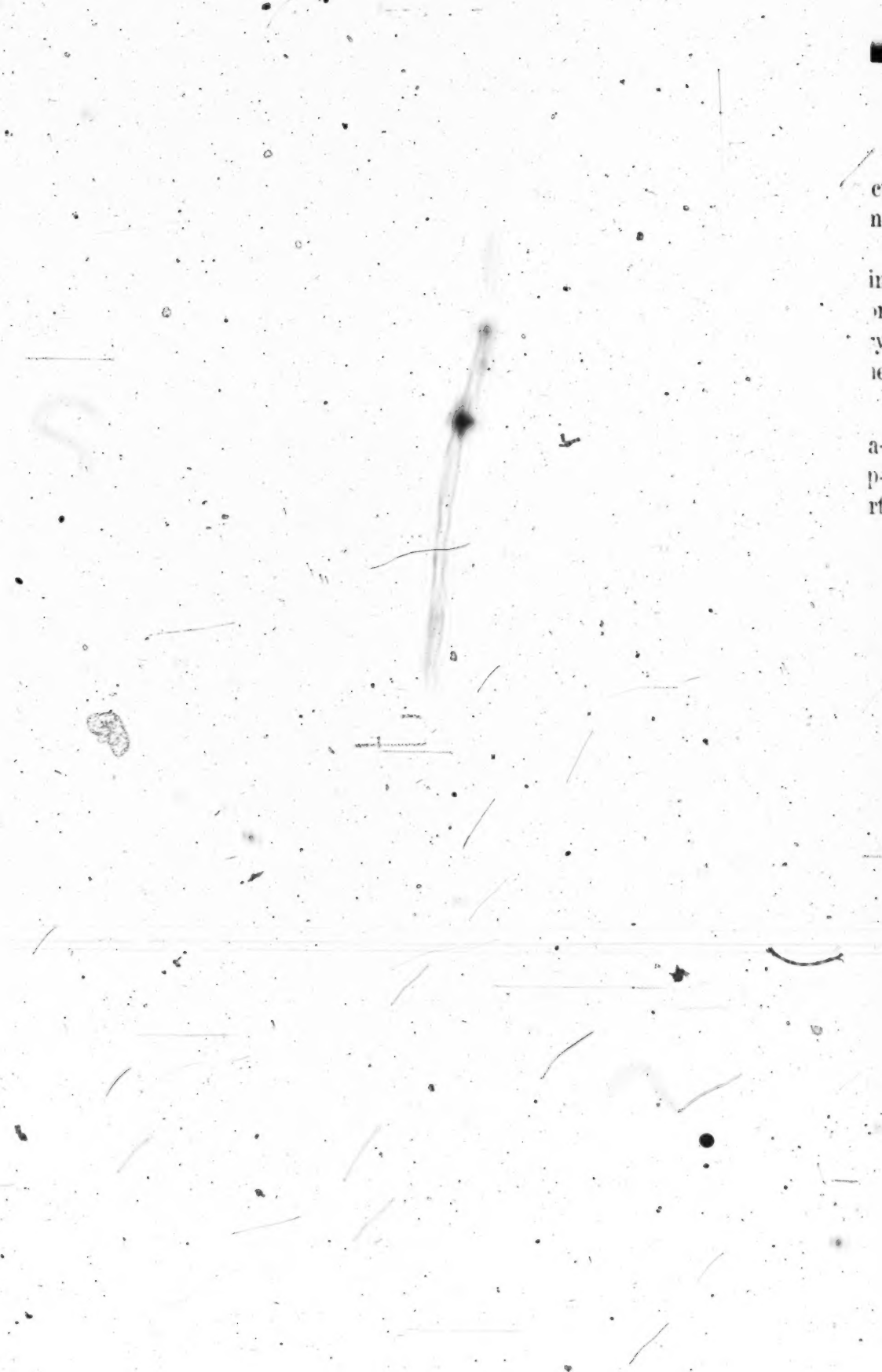
(2) each such solicitation is accompanied or preceded by a copy of a report on the plan which shall be made by the Commission after an opportunity for a hearing on the plan and

other plans submitted to it, or by an abstract of such report made or approved by the Commission; and

(3) each such solicitation is made not in contravention of such rules and regulations or orders as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers.

Nothing in this subsection or the rules and regulations thereunder shall prevent any person from appearing before the Commission or any court through an attorney or proxy.

U. S. GOVERNMENT PRINTING OFFICE: 1935



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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1939.

Nos. 23 and 24.

In the Matter of

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.,
a corporation,

Debtor.

THOMAS K. CASE and ADELE B. COWAN,

Petitioners,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.,
a corporation,

Respondent.

PETITION OF RESPONDENT FOR REHEARING.

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IN THE

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LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,

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THOMAS K. CASE and ADELE B. COWAN,

Petitioners,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD., a corporation,

Respondent.

PETITION OF RESPONDENT FOR REHEARING.

To the Honorable Charles Evans Hughes, Chief Justice, and to the Honorable Associate Justices of the Supreme Court of the United States:

Respondent files this petition for rehearing and briefly states its grounds therefor as follows:

Summary of Statement of Grounds for Rehearing as Requested by Paragraph 2(f) of Rule 27.

POINT I.

We Submit That This Honorable Court Erred in Concluding That the Respondent Corporation, a Legal Entity Distinct From the Class A Stockholders, Could, by the Commencement of the 77B Proceeding, Waive the Vested Right of the Class A Stockholders to Insist That the Bondholders Live Up to Their Contract Not to Foreclose the Bonds Until 1944, Which Right, Among Others, Was Obtained by the Class A Stockholders Under the Reorganization Agreement of 1930, at a Cost to Them of $400,000.00.

The Class A stockholders of respondent corporation, as such, have a separate and distinct legal status and are in no way identical with respondent corporation. As to them, the respondent corporation is a separate—and may be an antagonistic—legal entity. In addition to their rights as stockholders under the articles of incorporation, the Class A stockholders obtained, at a cost of $400,000.00, by virtue of the 1930 reorganization agreement—and still have—a vested right to insist that the bondholders do not foreclose until 1944 the trust indenture securing the corporation's bonds. Respondent corporation, by voluntarily filing a petition under Section 77B, could not waive, on behalf of the Class A stockholders, or otherwise affect, a valid and existing contract between these particular stockholders and the bondholders unless these stockholders consented, expressly or impliedly. *No such consent has ever been given, nor has the respondent corporation, or any one else, ever been authorized*

by the Class A stockholders to give such consent. The conditional consent to the proposed plan of reorganization of only a part of the Class A stockholders was expressly based upon their receiving the stock allotment provided in that plan, which was ultimately approved by the District Court. Neither the respondent corporation, nor the Court, had the power to alter that plan without the requisite consent of the Class A stockholders as a class.

We respectfully submit that when the Congress, in adopting Section 77B, stated, in subdivision (e)(1) thereof, that a plan of reorganization "shall not be confirmed until it has been accepted in writing * * * by or on behalf of stockholders of the debtor holding a majority of the stock of each class, * * * provided, however, that such acceptance shall not be requisite to the confirmation of the plan by any stockholder or class of stockholders if the judge shall have determined * * * that the debtor is insolvent, * * *", it was referring to stockholders having the usual rights arising under the articles of incorporation and was not referring to a situation such as is involved in this case, where the Class A stockholders have, in addition to the usual rights arising under the articles of incorporation, a vested contractual right as against the bondholders of the respondent corporation and as against the respondent corporation itself, acquired by the payment of a large sum in cash.

This Honorable Court, in its decision of November 6, 1939, holds that this vested contract right—which belonged to the Class A stockholders as a class and for which they paid $400,000.00—was waived on their behalf by respondent corporation when it filed the petition for

reorganization under Section 77B. It is respectfully submitted that such a conclusion does not do equity and is untenable. In what way may it be said that these particular stockholders waived or gave up this valuable right? There is nothing in the record indicating that the respondent corporation, or its board of directors, was ever authorized by the Class A stockholders to waive or surrender that right.

How can it be said that any plan of reorganization will be fair and equitable which abrogates completely this vested contract right of the Class A stockholders—not only without adequate compensation but also without any compensation, and even without submitting the matter to them for their consideration?

Proceedings in reorganization under Section 77B are proceedings in bankruptcy. *Schwartz v. Irving Trust Co.*, 299 U. S. 456, 462. An adjudication in bankruptcy absolves from no agreement, terminates no contract, and discharges no liability, and the same is true of the approval of a debtor's petition for reorganization under Section 77B. *Johnson v. Kurn* (C. C. A. 8, 1938), 95 Fed. (2d) 629, 36 A. B. R. (N. S.) 418. But, in the opinion filed by this Honorable Court in connection with its decision of Nov. 6, 1939, the broad position is taken that the otherwise valid vested contract rights of the Class A shareholders were wiped out by the institution of the 77B proceeding by the debtor corporation itself. We submit that these vested rights could only be diminished, or wiped out, by these shareholders themselves, as a class, by the composition method provided by Section 77B-(e)-(1), *i. e.*, by a majority vote of the stock of that class of shareholders, with the concurrence of the district judge that the plan is fair

and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible (Section 77B-(f)). Otherwise, we submit that any plan which wiped out or ignored without their consent, these shareholders, who held such vested contract rights, would be invalid because it violated the Fifth Amendment to the Constitution of the United States. *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555, 28 A. B. R. (N. S.) 397, 55 S. Ct. 854, 79 L. Ed. 1593; *Tennessee Publishing Co. v. American National Bank* (C. C. A. 6, 1936), 81 Fed. (2d) 463, 30 A. B. R. (N. S.) 521, 299 U. S. 18, 81 L. Ed. 13, 57 S. Ct. 85, 32 A. B. R. (N. S.) 180.

This Honorable Court also holds that the District Court obtained jurisdiction over the *res* when it approved, as properly filed, the petition under Section 77B. But what was that *res*? It was the physical properties of the respondent corporation, not free and clear, certainly, but charged with the obligations of the trust indenture securing respondent's bonds. One of the then valid and existing provisions of this trust indenture prevented, until 1944, a foreclosure because of nonpayment of interest and unless an event of default remained uncorrected after notice thereof. No such event of default has occurred. Was it fair or right for this Honorable Court to assume that other events of default might have occurred when such was not the fact, and when the District Court, after meticulous consideration of the entire matter, as shown by the record, found no such default? [R. p. 208.] We would also respectfully urge that the moratorium against foreclosure until 1944 was not only as a result of the contract between (1) the respondent corporation, (2) the bondholders, and (3) the Class A stockholders, but was

also made a part of the bond issue trust indenture by proper amendment [R. p. 321].

May we also respectfully submit that the District Court did not permit participation by Class A stockholders because of the "nuisance value" of their position, but because they had a valuable vested right, which the Court felt it fair and equitable to recognize.

POINT II.

If the Court Will Rule at This Time Upon Two of the Main Contentions of Petitioners Case and Cowan, Future Litigation Based Thereon in This Proceeding May Be Avoided.

Petitioners Case and Cowan claim:

That they are in a class by themselves as the only remaining *bona fide* holders of first mortgage bonds of respondent, are entitled to have the lien of the trust indenture enforced and their bonds paid in full, and that any other treatment of them would be violative of the rights vouchsafed to them in their bonds and under the trust indenture if accomplished by amendment of the trust indenture and would not give them "adequate protection" if done under Section 77B for the following reasons:

(1) That they have never consented as bondholders to any reorganization of respondent, either the voluntary one in 1930 or the present proceeding under Section 77B;

(2) That no majority consent of bondholders, however large, whether pursuant to the amendment provisions of the trust indenture as in the 1930 reorganization or pursuant to the provisions of Section 77B as in the present proceeding can bind them.

Respondent, on the contrary, claims:

(1) That the bond issue trust indenture was amended in accordance with the amendment provisions thereof in 1930; and

Therefore petitioners, even though among the minority of bondholders not consenting thereto, were bound by said amendment;

(2) That in a proceeding under Section 77B the District Court is empowered to approve a plan which has been consented to by the holders of the requisite percentage of bonds in the class if the plan is found to be fair and feasible and not discriminatory in favor of any class; and

Therefore petitioners, even though among the minority of non-assenting bondholders of the class of which the requisite majority in amount consented thereto, would be bound by such plan, notwithstanding the fact that their rights are materially altered under such a plan; and

(3) The provisions of subdivision (b)(5) of Section 77B are not applicable where the confirmed plan has been consented to by the holders of the requisite amount of bonds in the class.

The District Court ruled in favor of respondent on all of these points [R. pp. 108, 219, 228, 244, 313, 321, 328] and the holding was not disturbed by the Circuit Court [R. pp. 374, 376-380]. Respondent respectfully submits that the decision of this Honorable Court does not decide these points and therefore petitioners or any other bondholders of respondent similarly situated will not be barred from raising the same questions again in this proceeding, regardless of whatever plan which treats all of respondent's bondholders alike may ultimately be approved by the District Court and consented to by the requisite percentage of security holders of respondent.

ARGUMENT.

POINT I.

We Submit That This Honorable Court Erred in Concluding That the Respondent Corporation, a Legal Entity Distinct From the Class A Stockholders, Could, by the Commencement of the 77B Proceeding, Waive the Vested Right of the Class A Stockholders to Insist That the Bondholders Live Up to Their Contract Not to Foreclose the Bonds Until 1944, Which Right, Among Others, Was Obtained by the Class A Stockholders Under the Reorganization Agreement of 1930, at a Cost to Them of $400,000.00.

The facts of the 1930 voluntary reorganization of respondent are set forth in the appendix to respondent's brief in opposition to petition for writ of certiorari and in the opinion of this Honorable Court. Respondent however, deems it necessary and of great importance to again analyze and consider the contract entered into in 1930 between the Class A stockholders of respondent as a separate and distinct group apart from respondent, as an entity, and the bondholders of respondent, as a group. This contract or voluntary plan of reorganization in 1930 was as follows:

The Class A stockholders of respondent contributed $400,000 to respondent as new working capital. In consideration for this new capital the bondholders agreed to and did or cause to be done the following: The trust indenture was amended to reduce the interest and make it payable only if earned and those of the contributing stockholders subject thereto were released from any possible stockholders' liability for the payment of the bonds under the California law then in existence.

The bondholders, by virtue of this contract, gained the benefit of $400,000 of new working capital in respondent corporation or its subsidiary and the Class A stockholders gained, by this contract, a vested right to postpone foreclosure of the trust indenture until 1944 and a release of stockholders' liability on the bonds.

This contract right postponing foreclosure until 1944 was acquired for said valuable consideration by the Class A stockholders from the bondholders, each of these groups being distinct and apart from each other and from respondent as an entity. This right was also acquired from the respondent corporation as a consideration for the payment into the treasury of the $400,000. The Class A stockholders paid for this right. It was theirs and did not belong to respondent. We submit that respondent had no power to change or affect this vested right in any way by waiver or otherwise. As fully discussed in other briefs, the plan of reorganization of 1937, now before this Court, was developed and promulgated by respondent after extended negotiations among the officers of the respondent corporation, the bondholders, and the Class A stockholders. To the corporation's directors was left the power to decide whether to consummate the reorganization with or without a 77B proceeding, but whichever way was chosen, the conditions were the same, so far as the rights of the Class A stockholders were concerned.

As we have repeatedly pointed out, the Class A stockholders were vested with a valuable right, which would have to be abrogated if an immediate reorganization were to be effected. Nothing was due to the bondholders on account of their bonds. They could not foreclose the

trust indenture, or obtain relief thereunder, until 1944. The right to postpone foreclosure did not arise in favor of the Class A stockholders out of the articles of incorporation of respondent; that right grew out of and was based on the 1930 contract between the bondholders and the Class A stockholders [R. pp. 76, 87, 227, 228, 313]. Under the 1937 plan of reorganization, confirmed by the District Court, the bondholders said to the Class A stockholders, in effect: "If you will now give up this valuable right to postpone foreclosure, we will consent to a plan of reorganization of respondent corporation which will give you participation in the reorganized company. That will be your compensation for giving up this right and agreeing to this plan." In consideration of such participation, this proposition was accepted and agreed to by more than ninety-eight per cent (98%) of the Class A stockholders.

Respondent promulgated the 1937 plan in good faith [R. pp. 244, 328]. Its board of directors decided that there were not consents of bondholders, close enough to 100 per cent to consummate the plan by the voluntary route. Therefore a 77B proceeding was inaugurated [R. pp. 80, 313]. We submit that this act on the part of respondent corporation could not divest the Class A stockholders of any vested contract right, nor could it create or change the powers of the District Court under Section 77B to pass upon all of the rights of stockholders and security holders of respondent and upon the fairness and equitableness of the plan. The plan and the participation of the Class A stockholders was at all times subject to the ultimate approval of the court. Vigorous representation was made as to the merits and demerits of the plan before the Court during the proceedings [R. pp. 307, 308]. The findings of the District Court

and the District Court's decision show the exactness and thoroughness with which all phases were inquired into. The District Court found this vested contract right of the Class A stockholders to be valid and to exist, and petitioners accepted this decision and did not question it on this appeal. The District Court [R. pp. 227, 228, 321] evaluated that vested contract right and decided that the forebearance of the Class A stockholders or the giving up by them of their right to delay foreclosure until 1944 was the principal consideration passing from them to the bondholders to justify the participation of these stockholders under the plan and was in all respects adequate and fair.

Respondent submits that the decision of this Honorable Court now rests squarely on the basis that whatever right the Class A stockholders had under the 1930 contract, and under the 1937 plan of reorganization, was waived or abandoned on their behalf by *respondent corporation* when the jurisdiction of the District Court was invoked by the respondent corporation *alone*. This ground for this decision, we respectfully urge, is neither justified by the equities of the situation, nor is it sound logically. To maintain such a theory, this Honorable Court must find in respondent corporation the power to waive or abandon the contract right vested in the Class A stockholders. Such power in respondent corporation must have been created by the Class A stockholders, or must have arisen from circumstances which would force a court of equity to look through the "corporate veil", disregard the separate entities and hold that respondent corporation and its Class A stockholders are one and the same. It must then hold that the power to waive or surrender a vested contract right, which theretofore existed in the Class A

stockholders alone, after the petition in 77B was filed, also existed in respondent corporation.

On the first alternative—we look in vain for any authority granted by Class A stockholders to respondent corporation to waive, surrender, or abandon their vested right. The 1937 reorganization plan, confirmed by the District Court, was based on the agreement of the Class A stockholders to give up their right to postponement of foreclosure until 1944 upon receipt of twenty-three per cent (23%) of the common stock of the new company, and the consideration therefor was to pass to them upon the consummation of the plan. The Class A stockholders, as a class, had to agree first, before any step could be taken to reorganize the bondholders. This plan immediately gave the assets to the new company and gave the bondholders, as preferred stockholders, the practical equivalent of foreclosure. This saved to the bondholders all of the expensive burdens of complying with the trust indenture during such period, as well as the expense and burden of a foreclosure proceeding. Surely nothing would be more inequitable or untenable than a holding that, when the consideration for a contract consists of the surrender of a right by the first party for which the second party agrees to pay, and by which he obtains an advantage, the second party may retain the advantage of the surrender and not be required to make the agreed payment therefor.

The 1937 plan recognized the 1930 contract, wherein the vested contract right was created between the Class A

stockholders and the bondholders. The 1937 plan provides a 77B proceeding as an alternative method of consummation, but, we submit, it grants no authority to respondent corporation to surrender or waive the vested contract right of the Class A stockholders granted to them in 1930. On the contrary, it reassures and guarantees to the Class A stockholders that upon the consummation of the plan these stockholders will be compensated and be permitted to participate in the reorganized company as the consideration for the surrender by them of their vested contract right to postpone foreclosure until 1944. The District Court, we submit, would have violated the provisions of Section 77B had it failed to take into consideration the relative classifications of the Class A stockholders, the Class B stockholders, and the bondholders under the 1930 contract, and any plan which failed to adequately compensate the Class A stockholders for the abrogation of their vested right acquired thereunder would not, we submit, be fair and equitable.

On the second alternative—does there exist in the present case a set of circumstances making it necessary for a court of equity to disregard the separate entities of the Class A stockholders and respondent corporation to avoid an inequitable result? We submit that the very statement of the case forces a conclusion that this proceeding is one which requires a segregation of the corporate entity from the Class A stockholders, as a group, to produce a fair and just result.

The California cases are numerous supporting the proposition that the stockholders of a corporation have a separate status distinct from the corporate entity. Some of the late cases are the following:

Erkenbrecher v. Grant (1921), 187 Cal. 7, 11;

Wood Estate Co. v. Chanslor (1930), 209 Cal. 241, 245;

Cleaning & Pressing Co. v. Hollywood Laundry Service (1932), 217 Cal. 124, 129;

Dos Pueblos Ranch & Improvement Co. v. Ellis (1937), 8 Cal. (2d) 617, 621.

This ruling will be followed by the Federal Courts.

In re Sterling (C. C. A. 9, 1938), 97 Fed. (2d) 505 (cert. den. 83 L. Ed. 22);

Erie R. R. Co. v. Tompkins (1938), 304 U. S. 64, 82 L. Ed. 1188, 58 Sup. Ct. Rep. 817.

We submit, therefore, that the 1930 plan of reorganization vested in the Class A stockholders, independent and distinct from respondent corporation, a contract right to postpone foreclosure under the bond issue trust indenture for anything short of failure to pay interest, if earned, until 1944. Under the 1930 plan, the voting control of respondent, through its board of directors, was vested in George A. Armes *at the instance of the bondholders* [R. pp. 101, 313]. It is submitted that if Section 77B had been in existence immedately after the consummation of the 1930 plan, the then board of directors of the respondent corporation could not have effectuated a plan which would have been tantamount to foreclosure of the bonds, without the consent of the Class A stockholders, by Section 77B or any other means, and that by the same token, the

respondent corporation can not now, by taking advantage of Section 77B, bring about the same result, that is, the abrogation of the vested right of the Class A stockholders to prevent foreclosure, without adequately compensating such stockholders therefor.

The District Court, in July of 1938 [R. p. 208], found and held:

> "The evidence shows that the bondholders are not now in a position to foreclose because, by the terms of the amended trust indenture, no default can be predicated upon a failure to pay interest unless earned—and that the interest has not been earned. This relief from the possibility of a default under the bond issue was one of the main considerations, running to the Class A stockholders when the additional capital of $400,000 was provided.'"

We respectfully submit that it is untenable that the bondholders should now be permitted under a plan of reorganization of respondent corporation in a Section 77B proceeding to disregard the right of shareholders to postpone foreclosure until 1944 and to do what is tantamount to effecting foreclosure of the bond issue trust indenture at this time. That any procedure based on such a plan would be unfair and inequitable was the decision of the District Court. Respondent submits, however, that the bondholders are granted such right by the decision of this Honorable Court, and by said decision the Class A stockholders are divested of their right to have foreclosure postponed until 1944 without any compensation therefor whatever, and without their consent, or the consent of any of them. We submit that any plan now filed by the bondholders, where they seek to possess themselves of the entire assets of the respond-

ent corporation and thereby to bring about the effective results of foreclosure of their bonds, would not be a plan of reorganization but would be an attempt to obtain foreclosure by a short cut and, hence, would not be filed in good faith, and for that reason, could not be approved by the District Court.

For the purpose of a further analysis of this Honorable Court's decision, let us assume a reorganization situation where there is no vested contract right in the stockholders but merely their usual rights arising under the articles of incorporation, as follows:

A corporation has stock and bonds outstanding with all of its existing and after-acquired assets subject to the lien of the bond issue indenture. The value of its assets is $830,000.00, which is less than the amount of the bonded indebtedness by more than $400,000.00. The corporation requires $400,000.00 cash immediately as working capital and to save valuable assets and under a plan of reorganization approved by substantially all of its stockholders and bondholders the stockholders agree to and do immediately advance $400,000.00 to the corporation as a contribution to capital because of the dire need therefor and *prior* to the commencement of the 77B proceedings, but with the provision in the plan that the stockholders are to receive a minority and junior stock position in the reorganized company, the bondholders being accorded a prior stock position. Under the circumstances so assumed *and apart from the plan*, when the corporation files its 77B petition, the rights of all stockholders and all creditors *as such* (other than the bondholders) will be wiped out because the assets subject to the lien of the bond issue indenture will be less than the amount of the bonded indebtedness.

When applied to these assumed facts, the decision of this Honorable Court in the instant case would force a District Court to find the plan unfair because the $400,000.00 was advanced by the stockholders shortly prior to the institution of the 77B proceedings and all rights of stockholders were waived by the corporation by the filing of the 77B petition, whereas the same plan could properly be found to be fair and equitable had the $400,000.00 in cash been advanced immediately after the institution of the 77B proceeding.

We submit that the time when the new contribution is made, if it is made pursuant to a plan, is immaterial in the determination of the question of the fairness of the plan. The question should be decided by the District Court on the basis of whether the contribution was adequate and not on the question of whether it was made before or after the institution of the 77B proceeding. Further, even under the facts of the assumed case, where the stockholders' only rights were under the articles of incorporation, we would also urge and contend that the decision of the District Court on the fairness of the plan should not turn or be based upon the proposition that technically the stockholders' rights were lost or waived by the institution by the corporation of the 77B proceedings.

We do not contend that a District Court is in anywise precluded from passing on the fairness of a plan because it was approved by a large majority of all affected security holders prior to the institution of the 77B proceedings. *We do not contend* that a District Court is in anywise bound to follow such a previously approved plan if it is in fact unfair. *We do contend* that if a plan entered into prior to the institution of the 77B proceedings was mani-

festly fair when it was entered into, because each group participating therein contributed an adequate consideration for its participation in the plan, and such plan provided for its consummation in 77B proceedings, the institution of the 77B proceedings should not be held to cause the plan to become unfair by reason of the fact that if it were not for the provisions of the plan, the value of the consideration given by one group of participants would ordinarily have been wiped out under the rules applying to bankruptcy claims.

Now we revert to the instant case pending before this Honorable Court. We contend: First, the respondent corporation could not waive the existing vested contract right in the Class A stockholders which arose out of the 1930 plan of reorganization; and, second, that even apart from the inability and lack of power in the respondent corporation to waive such right, the institution of a 77B proceeding whether by a debtor or security holders of debtor, should never be held to have the effect of making unfair a plan which was fair immediately prior to the institution of such proceedings and which plan provided for its consummation in the 77B proceedings.

We have discussed elsewhere the findings of the special master and the District Court as to the adequacy of the consideration flowing from the Class A stockholders to justify their participation under the plan. The forbearance to exercise a right may be just as valuable a consideration as a contribution in money. The Class A stockholders had a right to prevent foreclosure until 1944, a period of eight years, at the time the 1937 plan was formulated in the spring of 1936. That the forbearance or waiver of the right was equal in value to the participation

afforded under the plan to the Class A stockholders was found to be a fact by the special master, by the District Court and by 90-plus per cent of the bondholders. The record of the evidence upon which this finding is based is not before the Court and petitioners Case and Cowan did not question this finding. This Honorable Court, in its decision, held that the conclusion of the District Court that the virtual abrogation of the agreement deferring foreclosure until 1944 justified participation by the stockholders in the plan was erroneous and the basis for the error as pointed out by this Honorable Court was that the consideration had been waived. We do not interpret the language used by this Honorable Court in its decision to convey the meaning or the holding that if there had been no waiver, the consideration would not have supported the issuance of the stock. In respondent's supplemental brief in opposition to petition for writ of certiorari, we called this Court's attention to the decision of the Circuit Court of Appeals for the 7th Circuit in *In re Georgian Hotel Corporation*, 82 Fed. Rep. (2d Series), p. 917, in which case this Honorable Court denied certiorari in 298 U. S. 673. From the reported decision of the Circuit Court in 82 Fed. Rep. (2d Series) at page 919, it would appear that the consideration which was the basis of the allotment of a 30% stock interest to subordinate creditors was a waiver of a statutory right of redemption which would have been vested in said subordinate creditors for a few months upon a foreclosure of the first mortgage. We cited this decision because the facts as to the consideration were similar to the instant case in that in both situations the consideration arose from the waiver of a right. We also believe that the Circuit Court for the 7th Circuit was correct in its conclusion when it left the determination of the adequacy of the

consideration flowing from the subordinate creditors to the judicial discretion of the District Court.

This is not a case of the stockholders at the last minute conjuring up a "nuisance value" to prevent or delay a foreclosure or a 77B reorganization. The vested right upon which the Class A stockholders' claim is based was created in 1930 for the valuable consideration of $400,000. It has existed in the Class A stockholders and been recognized and lived up to by the bondholders through all these years. Neither litigation nor attempted foreclosure, we submit, could disturb the vested right to postpone foreclosure until 1944 as it existed in the Class A stockholders. These stockholders had to be persuaded in some way voluntarily to surrender and abrogate this right. It was upon this basis that the 1937 plan of reorganization was conceived and promulgated by the respondent corporation and confirmed by the District Court. We submit that the decision of this Court works an inequitable result and a wholly unfair disposition of the vested contract right of the Class A stockholders.

We submit that the case at bar is one such as was discussed at page 17 of the opinion of this Honorable Court, wherein the Court recognizes that settlements of honest differences and conflicting claims do not constitute a bowing of the District Court to nuisance claims, but, rather, a consideration of the reorganization proceedings in an economical and practical manner. We respectfully urge that the position taken by this Court is untenable when it states that "any strategic position occupied by the stockholders prior to these proceedings vanished once the Court invoked its jurisdiction". This position is logical and tenable if the

rights of the stockholders in a proceeding arose solely out of the articles of incorporation of a debtor, but not, we submit, when the right of the stockholders arose, as here, under a contract independent and separate from the articles of incorporation. Respondent submits that the vested contract right of its Class A stockholders to postpone foreclosure did not vanish when respondent corporation filed its 77B petition.

As pointed out in other briefs, respondent agrees with the views of this Honorable Court expressed in *In re 620 Church Street Building Corp.*, 299 U. S. 24, and has never argued that stockholders of an insolvent debtor should be granted participation except and unless they present adequate consideration therefor. We would not object to this Court's decision in the instant case if the Class A stockholders' rights arose only from the articles of incorporation of respondent. In those circumstances we would say, with Mr. Justice Douglas, that when the Court's jurisdiction is invoked, the junior stockholder interest "assumes all the consequences which flow from that jurisdiction". We do wish to urge, however, with all of the earnestness and strength at our command, that when there is a vested contract right in a class of the stockholders to be protected and dealt with, arising independently of the debtor's articles of incorporation, that such right could not be waived, surrendered or abandoned simply because debtor filed its petition under Section 77B. On the contrary, in this case it was reassured and guaranteed to the Class A stockholders that they would be compensated therefor by being permitted to participate in the new company as provided in the 1937 plan. The surrender of that valuable right was their immediate contribution to the reorganization and was not a "nuisance

value" position that these stockholders were giving up. What they had was a promise on the part of the bondholders not to squeeze them out until 1944.

Respondent calls the attention of this Court to the fact that the District Court found [R. p. 327] that the 1937 plan, confirmed in these proceedings, was consented to by the holders of 56,920.180 shares of respondent's Class A stock, representing 98-plus per cent of all of the outstanding Class A stock of respondent. Respondent submits that, as to the Class A stockholders who did not consent to the 1937 plan, either before or after the filing of the 77B proceeding, that, even under the waiver theory adopted by this Honorable Court, said stockholders' rights under the contract still exist and must be dealt with by the District Court in any determination as to the fairness and equitableness of a plan of reorganization. Furthermore, respondent submits that each of said Class A stockholders, whether he consented or not, can and may litigate his claim to his contract right in this proceeding if a plan is not adopted which satisfies him and which compensates and fairly deals with the Class A stockholders as a class on account of their right under the 1930 contract. We can see no program of fair dealing upon which a plan can be confirmed which does not deal with and fairly compensate the Class A shareholders. They, as stockholders, separate and distinct from the corporate entity (respondent) are the holders of a vested contract right which cannot be divested without adequate compensation therefore being afforded the holders thereof.

As stated above, no attempt was made to curtail or broaden the District Court's jurisdiction in

the 77B proceedings by the provisions of the 1937 plan, which was agreed to by more than the requisite majority of affected parties prior to the filing of the petition. The 1937 plan was attached to the petition as an exhibit [R. p. 132] and on January 28, 1938, the District Court entered its order approving said petition as properly filed under Section 77B. On March 18, 1938 [R. p. 133], pursuant to order of the District Court, the modification to the 1937 plan was proposed and filed by debtor. The plan as filed with the original petition and the modification thereof provided, subject to the approval and confirmation by the Court, for the treatment to be accorded to the Class A stockholders for and in consideration of the abrogation of their contract right to postponement of foreclosure until 1944. Such disposition of the stockholders' claim under the contract did not limit the jurisdiction of the Court. On the contrary, it was submitted by the respondent corporation to the Court as a proposed plan which would fairly compensate the Class A stockholders for the surrender of their vested contract right. The District Court, we submit, was not bound by the plan, but if the District Court should have determined to depart from the plan, it would then have been necessary to resubmit the proposition to the Class A shareholders to ascertain whether or not the revised disposition of their claim would receive the necessary majority consent on the part of said shareholders. This procedure, in fact, was followed by the District Court when the modification of the plan was proposed on March 18, 1938 [R. p. 133]. The District Court ordered a notice mailed covering such modification to each Class A shareholder and, under the order, it was provided that said Class A shareholders could withdraw their consents to the plan as the same was modified on or

before April 11, 1938, and Class A stockholders failing to so withdraw would be deemed to have consented to said modification. The Court will recall that, under the modification of the plan, the percentage of participation by the Class A shareholders was substantially reduced. Such reduction gave rise to the Court's order that the modification adversely affected the Class A shareholders and therefore, under the provisions of Section 77B, the modification had to be submitted to said shareholders for reconsideration and vote by them as a class. This procedure, we submit, was fair and equitable and would have been and will be the only fair and equitable procedure upon a modification which further reduces or entirely eliminates the participation of the Class A shareholders.

Respondent takes this position and respectfully urges it before this Court on the ground that the Class A shareholders have a vested right under a contract (independent of their rights as shareholders under respondent's articles of incorporation) and such vested right cannot be divested in the absence of the requisite consents, unless the holders thereof are adequately compensated therefor. The failure of any plan to receive the consent of a majority in amount of the Class A shareholders, we submit, would prevent confirmation thereof.

At page 15 of this Honorable Court's decision a statement is made that "When that jurisdiction attached, the Court, rather than the stockholders, was in control with all of the powers and duties which that entailed under 77B."

As to the vested right of the Class A stockholders based upon the 1930 contract, we submit that the Court's "con-

trol" and disposition thereof was limited by the provisions of the Constitution of the United States as well as the provisions of Section 77B. Certainly, we submit, such vested contract right was not waived by the filing of the 77B petition by respondent corporation. We submit that it is equally certain that the District Court is not accorded, under Section 77B, the power or the duty to approve a plan of reorganization of respondent which would be tantamount to a foreclosure of the trust indenture at this time in contravention of the commitment of the bondholders to the Class A stockholders in the 1930 amendment to the trust indenture which postponed foreclosure until 1944. If the bondholders are to be given all of the benefits of an immediate foreclosure and the provisions of the amendment to the trust indenture are to be done away with, we submit that the Class A stockholders must be fairly and adequately compensated for the waiver of their right to defer foreclosure until 1944.

We would summarize respondent's Point I and respectfully request the Court's pardon for any reiteration or repetition, as follows:

In reaching its decision, this Honorable Court concluded that the right to defer or put off foreclosure until 1944 was "necessarily waived or abandoned on invoking the jurisdiction of the federal court in these proceedings". The respondent corporation (debtor in the District Court) filed the voluntary proceeding under Section 77B. No act of the debtor as a separate legal entity could affect or disturb the vested contract right of its Class A stockholders under an existing contract with its bondholders. The decision

of this Honorable Court merges the respondent corporation and its Class A stockholders and permits an act of the respondent corporation to constitute a waiver of vested rights of its Class A stockholders without said stockholders' consent thereto. Such a decision under the cases pointed out above should only be reached if an inequitable result would flow from the maintenance of the separate entities of the respondent corporation and its Class A stockholders. Respondent submits that a fair and equitable result could be obtained only by honoring the diverse entities and enforcing and placing a value upon the vested right of the Class A stockholders under the 1930 contract and compensating them therefor by permitting them to participate under the plan based upon a surrender and abrogation of their right to postpone foreclosure until 1944.

It is therefore clear to respondent that the decision of this Honorable Court is based squarely upon a surrender of this vested contract right of Class A stockholders brought about by respondent by filing voluntarily under Section 77B. Respondent argued in its reply to the brief of the United States, *amicus curiae*, that any such decision of this Court would bring about an inequitable result. We have briefly again discussed this point herein with the hope that this Court will reconsider its decision and affirm the conclusion of the District Court and the Circuit Court of Appeals for the Ninth Circuit that the consideration flowing from the Class A stockholders to the bondholders was adequate to support the par-

ticipation of the Class A stockholders under the plan and further that the act of the respondent by voluntarily filing a petition under Section 77B did not and could not disturb rights vested in a group, the Class A stockholders, separate from the respondent corporate entity, which right arose under the contract which was the basis of the 1930 reorganization. The Class A stockholders' vested contract right with which we are here concerned did not arise out of the articles of incorporation of respondent corporation, but rather, as stated, is based, upon and flows from the 1930 plan of reorganization agreed to and binding upon respondent corporation's bondholders. This Honorable Court's decision gives the bondholders all of the benefits of an abrogation of said 1930 plan without according to the Class A stockholders of respondent, parties to said plan, any compensation for said abrogation. The 1930 plan cost the contributing Class A stockholders $400,000 in cash for which they received a period of time until 1944 in which to operate without fear of foreclosure. Under the 1937 plan the Class A stockholders agreed to cut this period virtually in half, in consideration of a junior participation in the new company. This Court's decision takes away this vested contract right without providing any compensation whatever therefor. The disposition of this vested contract right under the 1937 plan and the compensation accorded the Class A stockholders was determined to be fair and equitable by the District Court after a full and careful consideration of the evidence, which evidence is not before this Court.

POINT II.

If the Court Will Rule at This Time Upon Two of the Main Contentions of Petitioners Case and Cowan, Future Litigation Based Thereon in This Proceeding May Be Avoided.

Petitioners Case and Cowan claim:

That they are in a class by themselves as the only remaining *bona fide* holders of first mortgage bonds of respondent, are entitled to have the lien of the trust indenture enforced and their bonds paid in full and that any other treatment of them would be violative of the rights vouchsafed to them in their bonds and under the trust indenture if accomplished by amendment of the trust indenture and would not give them "adequate protection" if done under Section 77B for the following reasons:

(1) That they have never consented as bondholders to any reorganization of respondent, either the voluntary one in 1930 or the present proceeding under Section 77B;

(2) That no majority consent of bondholders, however large, whether pursuant to the amendment provisions of the trust indenture as in the 1930 reorganization or pursuant to the provisions of Section 77B as in the present proceeding can bind them.

Respondent, on the contrary, claims:

(1) That the bond issue trust indenture was amended in accordance with the amendment provisions thereof in 1930; and

Therefore, petitioners, even though among the minority of bondholders not consenting thereto, were bound by said amendment;

(2) That in a proceeding under Section 77B, the District Court is empowered to approve a plan which has been consented to by the holders of the requisite percentage of bonds in the class if the plan is found to be fair and feasible and not discriminatory in favor of any class; and

Therefore, petitioners, even though among the minority of non-consenting bondholders of the class of which the requisite majority in amount consented thereto, would be bound by such plan, notwithstanding the fact that their rights are materially altered under such a plan and

(3) That the provisions of subdivision (b)(5) of Section 77B are not applicable where the plan has been consented to by the holders of the requisite amount of bonds in the class.

The District Court ruled in favor of respondent on all of these points [R. pp. 108, 219, 228, 244, 313, 321, 328] and the holding was not disturbed by the Circuit Court [R. pp. 374, 376-380]. Respondent respectfully submits that the decision of this Honorable Court does not decide these points and therefore petitioners or any other bondholders of respondent similarly situated will not be barred from raising the same questions again in this proceeding regardless of whatever plan which treats all of respondent's bondholders alike, may ultimately be approved by the District Court and consented to by the requisite percentage of security holders of respondent.

At page 21 of petitioners' brief in support of their petition for a writ of certiorari, three of petitioners' specifications of error are set forth as follows:

> "1. The Circuit Court of Appeals for the Ninth Circuit erred in concluding under the circumstances disclosed in this case, that petitioners, as dissenting bondholders, should be deprived of and lose their first mortgage lien, their right to foreclose and other substantive rights; [R. 274, 302.]
>
> * * * * * * * *
>
> 3. That the Court erred under the circumstances disclosed in this case, in sustaining a plan that is not fair because no compensation is provided for dissenting bondholders for the loss of their mortgage lien, and a plan which does not afford them the 'adequate protection' required by section 77B, subdivision (b) (5) of the Bankruptcy Act; [R. 275, 303.]
>
> 4. That the Court erred in depriving of their substantive rights, these petitioners as dissenting bondholders, as a minority who are not bound by any majority of consenting bondholders, however large, and that appellants cannot be deprived of their rights as 'non-assenting creditors' by any kind of a contract to which they are not actually a party, even though more than 75 per cent have consented to the proposed plan; [R. 276, 303, 304.]"

It is not necessary for respondent to lengthen this petition by enlarging on this ground for rehearing. A disposition by this Honorable Court of these points urged by petitioners will undoubtedly prevent a duplication of litigation in the lower courts and this Court in this proceeding on these points.

Conclusion.

Respondent respectfully urges this Honorable Court to grant a rehearing in this case on the grounds stated.

FARIES AND MCDOWELL,
DAVID R. FARIES,
J. CLIFFORD ARGUE,
GIBSON, DUNN & CRUTCHER,
J. C. MACFARLAND,
STUART L. LAPP,
Attorneys for Respondent.

Certificate of Counsel, Required by Rule 33.

State of California, County of Los Angeles—ss.

J. C. Macfarland, being first duly sworn, certifies, deposes and says that he is a member of the bar of the Supreme Court of the United States and is one of the attorneys for respondent, Los Angeles Lumber Products Company, Ltd., a corporation, in the proceedings in the Supreme Court of the United States in the above entitled matter; that the within and foregoing petition of respondent for rehearing in said matter is presented in good faith and not for delay.

J. C. MACFARLAND.

Subscribed and sworn to before me this 28th day of November, 1939.

[Seal] C. E. CULVER,
Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires: June 24, 1942.

pp. 6, 18, 10

SUPREME COURT OF THE UNITED STATES.

Nos. 23 and 24.—October Term, 1939.

Thomas K. Case and Adele B. Cowan and Estate of Adele B. Cowan, Deceased, Petitioners,
23 *vs.*
Los Angeles Lumber Products Company, Ltd.

Thomas K. Case and Adele B. Cowan and Estate of Adele B. Cowan, Deceased, Petitioners,
24 *vs.*
Los Angeles Lumber Products Company, Ltd.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[November 6, 1939.]

Mr. Justice Douglas delivered the opinion of the Court.

These cases[1] present the question of the conditions under which stockholders may participate in a plan of reorganization under § 77B (48 Stat. 912) of the Bankruptcy Act where the debtor corporation is insolvent both in the equity and in the bankruptcy sense. Because of the contrariety of tendencies in practical administration of the Act among the circuits as illustrated by the differences between the holding below (100 F. (2d) 963) and that in *In re Barclay Park Corp.*, 90 F. (2d) 595, we granted certiorari.

The debtor is a holding company owning all of the outstanding shares of the capital stock (except for certain qualifying shares held by directors) of six subsidiaries. Three of these have no assets of value to the debtor. Two have assets of little value. The debtor's principal asset consists of the stock of Los Angeles Shipbulding and Drydock Corporation which is engaged in shipbuilding and ship

[1] One involves an interlocutory order and the other a final order confirming a plan of reorganization under § 77B of the Bankruptcy Act.

repair work in California. This subsidiary has fixed assets of $430,000 and current assets of approximately $400,000. This subsidiary has only current debts of a small amount, not affected by the plan. The debtor's assets other than the stock of its subsidiaries aggregate less than $10,000.

The debtor's liabilities[2] consist of principal and interest of $3,807,071.88 on first lien mortgage bonds issued in 1924 and maturing in 1944, secured by a trust indenture covering the fixed assets of Los Angeles Shipbuilding and Drydock Corporation (one of the subsidiaries) and the capital stock of all of the subsidiaries. No interest has been paid on these bonds since February 1, 1929. In 1930, as a consequence of the financial embarrassment of the debtor, a so-called voluntary reorganization was effected. To that end, a supplement to this trust indenture was executed, pursuant to a provision therein, with the consent of about 97% of the face value of all the outstanding bonds, which reduced the interest from 7½% to 6% and made the interest payable only if earned. At the same time the old stock of the debtor was wiped out by assessment and new stock issued, divided into Class A and Class B, with equal voting rights. Class A stock was issued to some of the old stockholders who contributed $400,000 new money which was turned over to the Los Angeles Shipbuilding and Drydock Corporation and used by it as working capital. In consideration of this contribution the bondholders who agreed to the modification of the indenture likewise released the stockholders' liability under California law in favor of these contributors. Some Class B stock was issued to bondholders in payment of unpaid interest coupons.[3] At present there are outstanding 57,788 shares of Class A stock and 5,112 shares of Class B stock.

In 1937 the management prepared a plan of reorganization to which over 80% of the bondholders and over 90% of the stock assented. This plan of reorganization, as we shall discuss hereafter,

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[2] Other liabilities, not material here, are $6,075.94 of current accounts payable and $496,899.76 due the Los Angeles Shipbuilding and Drydock Corporation.

[3] A large block of Class B stock was escrowed under a management contract with one Armes to be delivered to him when all the bonds were retired and the Class A stockholders were paid back their $400,000 plus interest in the form of dividends. But this management contract was later terminated and the escrowed Class B stock was returned to the debtor and cancelled. Class A stock was preferred to Class B in the event of liquidation to the amount of $400,000 and interest.

provided for its consummation either on the basis of contract or in a § 77B proceeding, such election to be made by the board of directors. In January 1938 the directors chose the latter course and the debtor corporation filed a petition for reorganization under § 77B of the Bankruptcy Act, with the plan attached and reciting, *inter alia*, that the required percentage of security holders had consented to it. This plan as filed was later modified by the debtor, as we point out later, in a manner not deemed by us material to the issues here involved. That plan as modified provides for the formation of a new corporation, which will acquire the assets of Los Angeles Shipbuilding and Drydock Corporation,[4] and which will have a capital structure of 1,000,000 shares of authorized $1 par value voting stock. This stock is divided into 811,375 shares of preferred and 188,625 shares of common. The preferred stock will be entitled to a 5% non-cumulative dividend, after which the common stock will be entitled to a similar dividend. Thereafter all shares of both classes will participate equally in dividends. The preferred stock will receive on liquidation a preference to the amount of its par value. Thereupon the common will receive a similar preference. Thereafter all shares of both classes participate equally.

170,000 shares of preferred are reserved for sale to raise money for rehabilitation of the yards.[5] 641,375 shares of the preferred are to be issued to the bondholders, 250 shares to be exchanged for each $1000 bond. The Class A stockholders will receive the 188,625 shares of common stock, without the payment of any subscription or assessment. No provision is made for the old Class B stock. The aggregate par value of the total preferred and common stock to be issued to existing security holders is $830,000—an amount which equals the going concern value of the assets of the enterprise.

The plan was assented to by approximately 92.81% of the face amount of the bonds, 99.75% of the Class A stock, and 90% of the Class B stock. Petitioners own $18,500 face amount of the bonds. They did not consent to the so-called voluntary reorganization in 1930 whereby the trust indenture was amended. And throughout

[4] The assets of the debtor, except the capital stock of two subsidiaries which have assets of some, though slight, value will also be transferred to the new company. The assets of these two subsidiaries will be liquidated and the proceeds distributed pro rata among bondholders. The assets of the other three subsidiaries will also apparently be acquired by the new company.

[5] No underwriting of these funds is provided and no disclosure is made as to how the additional funds are to be raised.

the present § 77B proceedings they appropriately objected that the plan was not fair and equitable to bondholders.

The District Court found that the debtor was insolvent both in the equity sense and in the bankruptcy sense. The latter finding was based upon "appraisal and audit reports." In this connection the court found that the total value of all assets of Los Angeles Shipbuilding and Drydock Corporation was $830,000, those assets constituting practically all of the assets of the debtor and of its various subsidiaries of any value to the estate. Yet in spite of this finding, the court, in the orders now under review, confirmed the plan. And the court approved it despite the fact that the old stockholders, who have no equity in the assets of the enterprise, are given 23% of the assets and voting power in the new company without making any fresh contribution by way of subscription or assessment. The court, however, justified inclusion of the stockholders in the plan (1) because it apparently felt that the relative priorities of the bondholders and stockholders were maintained by virtue of the preferences accorded the stock which the bondholders were to receive and the fact that the stock going to the bondholders carried 77% of the voting power of all the stock presently to be issued under the plan; and (2) because it was able to find that they had furnished the bondholders certain "compensating advantages" or "consideration". This so-called consideration was stated by the District Court in substance as follows:

1. It will be an asset of value to the new company to retain the old stockholders in the business because of "their familiarity with the operation" of the business and their "financial standing and influence in the community"; and because they can provide a "continuity of management."

2. If the bondholders were able to foreclose now and liquidate the debtor's assets, they would receive "substantially less than the present appraised value" of the assets.

3. By reason of the so-called voluntary reorganization in 1930, the bondholders cannot foreclose until 1944, the old stockholders having the right to manage and control the debtor until that time. At least the bondholders cannot now foreclose without "long and protracted litigation" which would be "expensive and of great injury" to the debtor. Hence, the virtual abrogation of the agreement deferring foreclosure until 1944 was "the principal valuable

consideration" passing to the bondholders from the old stockholders.

4. Bonding companies are unwilling to assume the risk of becoming surety for the debtor or its principal subsidiary "because of the outstanding bond issue". The government's construction program will provide "valuable opportunities" to the debtor if it is prepared to handle the business. Hence, the value to the bondholders of maintaining the debtor "as a going concern, and of avoiding litigation, is in excess of the value of the stock being issued" to the old stockholders.

The Circuit Court of Appeals in affirming the decree confirming the plan stated that it was not possible for it to do other than accept these findings because of a stipulation and the state of the record thereunder. That stipulation provided for an abbreviated record and stated that the dissenting bondholders intended "to raise questions of substantive law only". But it also specified as errors, *inter alia*, the inclusion of stockholders in a plan where they have no equity and the finding that the plan was "fair" and "equitable". Thereby the stipulation adequately reserved the question of law as to whether on these facts the plan was fair and equitable within the meaning of § 77B. But in any event a stipulation does not foreclose legal questions. *Swift & Co.* v. *Hocking Valley Ry. Co.*, 243 U. S. 281, 289.

On that question of law we think that the District Court erred in confirming the plan and that the Circuit Court of Appeals erred in affirming that decree. We think that as a matter of law the plan was not fair and equitable.

At the outset it should be stated that where a plan is not fair and equitable as a matter of law it cannot be approved by the court even though the percentage of the various classes of security holders required by § 77B(f) for confirmation of the plan has consented. It is clear from a reading of § 77B(f)[6] that the Congress has required both that the required percentages of each class of security holders approve the plan and that the plan be found to be "fair and equitable". The former is not a substitute for the latter. The

[6] It provides in part: "After hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that (1) it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible; (2) it complies with the provisions of subdivision (b) of this section; (3) it has been accepted as required by the provisions of subdivision (e), clause (1) of this section; . . ."

court is not merely a ministerial register of the vote of the several classes of security holders. All those interested in the estate are entitled to the court's protection. Accordingly the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one. This is in line with the decision of this Court in *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, which reversed an order approving a plan of reorganization under § 77B, in spite of the fact that the requisite percentage of the various classes of security holders had approved it, on the ground that preferred stock of the debtor corporation was inequitably treated under the plan. The contrary conclusion in such cases would make the judicial determination on the issue of fairness a mere formality and would effectively destroy the function and the duty imposed by the Congress on the district courts under § 77B. That function and duty are no less here than they are in equity receivership reorganizations, where this Court said, "Every important determination by the court in receivership proceedings calls for an informed, independent judgment." *National Surety Co.* v. *Coriell*, 289 U. S. 426, 436.

Hence, in this case the fact that 92.81% in amount of the bonds, 99.75% of the Class A stock, and 90% of the Class B stock have approved the plan is as immaterial on the basic issue of its fairness as is the fact that petitioners own only $18,500 face amount of a large bond issue.

The words "fair and equitable" as used in § 77B(f) are words of art which prior to the advent of § 77B had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations. Hence, as in case of other terms or phrases used in that section, *Duparquet Huot & Moneuse Co.* v. *Evans*, 297 U. S. 216, we adhere to the familiar rule that where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary. *Keck* v. *United States*, 172 U. S. 434, 446.

In equity reorganization law the term "fair and equitable" included, *inter alia*, the rules of law enunciated by this Court in the familiar cases of *Railroad Co.* v. *Howard*, 7 Wall. 392; *Louisville Trust Co.* v. *Louisville, New Albany & Chicago Ry. Co.*, 174 U. S. 674; *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482; *Kansas*

City Terminal Ry. Co. v. *Central Union Trust Co.*, 271 U. S. 445. These cases dealt with the precedence to be accorded creditors over stockholders in reorganization plans.[1] In *Louisville Trust Co.* v. *Louisville, New Albany & Chicago Ry. Co., supra*, this Court reaffirmed the "familiar rule" that "the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors." And it went on to say that "any arrangement of the parties by which the subordinate rights and interests of stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation" (p. 684). This doctrine is the "fixed principle" according to which *Northern Pacific Railway Co.* v. *Boyd, supra*, decided that the character of reorganization plans was to be evaluated. And in the latter case this court added, "If the value of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control. In either event, it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever." (p. 508.) On the reaffirmation of this "fixed principle" of reorganization law in *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra*, it was said that "to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation" (p. 455). In application of this rule of full or absolute priority this Court recognized certain practical considerations and made it clear that such rule did not "require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock." *Northern Pacific Railway Co.* v. *Boyd, supra*,

[1] For analyses and reviews of these cases as applied to equity reorganizations or reorganizations under § 77B and § 77 of the Bankruptcy Act see Frank, Some Realistic Reflections on Some Aspects of Corporate Reorganization, 19 Va. L. Rev. 541; Swaine, Reorganization of Corporations: Certain Developments of the Last Decade, 27 Col. L. Rev. 901; Spaeth and Wiehe, The Boyd Case and Section 77, 32 Ill. L. Rev. 769; Bonbright and Berge, Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization, 28 Col. L. Rev. 127; Friendly, Some Comments on the Corporate Reorganization Act, 48 Harv. L. Rev. 39; 2 Gerdes on Corporate Reorganizations, § 1084.

p. 508. And this practical aspect of the problem was further amplified in *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra,* by the statement that "when necessary, they (creditors) may be protected through other arrangements which distinctly recognize their equitable right to be preferred to stockholders against the full value of all property belonging to the debtor corporation, and afford each of them fair opportunity, measured by the existing circumstances, to avail himself of this right" (pp. 454-455). And it also recognized the necessity at times of permitting the inclusion of stockholders on payment of contributions, even though the debtor company was insolvent. As stated in *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra,* p. 455: "Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. In such or similar cases the Chancellor may exercise an informed discretion concerning the practical adjustment of the several rights." But even so, payment of cash by the stockholders for new stock did not itself save the plan from the rigors of the "fixed principle" of the *Boyd* case, for in that case the decree was struck down where provision was not made for the unsecured creditor and even though the stockholders paid cash for their new stock. Sales pursuant to such plans were void, even though there was no fraud in the decree. *Northern Pacific Railway Co.* v. *Boyd, supra,* p. 504. As this Court there stated, p. 502, "There is no difference in principle if the contract of reorganization, instead of being effectuated by private sale, is consummated by a master's deed under a consent decree."

Throughout the history of equity reorganizations this familiar rule was properly applied in passing on objections made by various classes of creditors that junior interests were improperly permitted to participate in a plan or were too liberally treated therein. In such adjudications the doctrine of *Northern Pacific Railway Co.* v. *Boyd, supra,* and related cases, was commonly included in the phrase "fair and equitable" or its equivalent. As we have said, the phrase became a term of art used to indicate that a plan of reorganization fulfilled the necessary standards of fairness. Thus throughout the cases in this earlier chapter of reorganization law,

we find the words "equitable and fair",[8] "fair and equitable",[9] "fairly and equitably treated",[10] "adequate and equitable",[11] "just, fair and equitable"[12] and like phrases[13] used to include the "fixed principle" of the *Boyd* case, its antecedents and its successors. Hence we conclude, as have other courts,[14] that that doctrine is firmly imbedded in § 77B.

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[8] Jameson v. Guaranty Trust Co. of New York, 20 F. (2d) 808, 815, certiorari denied 275 U. S. 569.

[9] Flersheim v. National Radiator Corp., 64 F. (2d) 847, 852, rev'd 290 U. S. 504.

[10] P. R. Walsh Tie & Timber Co. v. Missouri Pacific Ry. Co., 280 F. 38, 44.

[11] Mountain States Power Co. v. A. L. Jordan Lumber Co., 293 F. 502, 506.

[12] St. Louis-San Francisco Ry. Co. v. M'Elvain, 253 Fed. 123, 134. See also Guaranty Trust Co. v. Missouri Pacific Ry. Co., 238 Fed. 812, 816, 819.

[13] Northern Pacific Railway Co. v. Boyd, *supra*, spoke of a "fair" offer to the creditor and a "just reorganization" as the prerequisite to validity of the plan (p. 508). Kansas City Terminal Ry. Co. v. Central Union Trust Co., *supra*, said that the offer to the creditor had to be "fair and binding" (p. 452).

[14] See In re Day & Meyer, Murray & Young, 93 F. (2d) 657; Tellier v. Franks Laundry Co., 101 F. (2d) 561; In re Philadelphia & Reading Coal & Iron Co., 105 F. (2d) 257; In re New York Railways Corp., 82 F. (2d) 739, 744; 2 Gerdes on Corporate Reorganizations, § 1085. Intimations to the contrary, Downtown Investment Association v. Boston Metropolitan Buildings, Inc., 81 F. (2d) 314, 323-324; In re A. C. Hotel Co., 93 F. (2d) 841, are not tenable.

The statutory scheme of § 77B (in those respects which are material here) is in sharp contrast to that which was provided for compositions under former § 12. This court said in Callaghan v. Reconstruction Finance Corp., 297 U. S. 464, 470: "Reorganizations now permitted under § 77B present certain resemblances to compositions under § 12, which have been commented upon as supporting the constitutionality of the reorganization provisions of § 77 or § 77B. . . . But § 77B contemplates a procedure and results not permissible under § 12. Reorganizations are nowhere referred to in the statute as compositions." Under § 12(a) (as it existed at the time § 77B was enacted) only a "bankrupt" could offer "terms of composition to his creditors". Under § 77B(d) plans may be proposed not only by the debtor but also by a designated percentage of the creditors or, where the debtor is not found to be insolvent, by a specified percentage of stockholders. Section 12(d) as it then existed provided that the judge "shall confirm a composition if satisfied" *inter alia* that "it is for the best interests of the creditors". See Fleischmann & Devine, Inc. v. Saul Wolfson Dry Goods Co., Inc., 299 Fed. 15. The "fair and equitable" standard employed in § 77B was not then present in § 12. Consent by the debtor to the composition was implicit in former § 12 (*cf.* In re Bryer, 281 Fed. 812). But under § 77B approval of a plan by security holders who have no equity in the enterprise is unnecessary. In re 620 Church Street Building Corp., 299 U. S. 24. The general view was well expressed in In re Dutch Wooderaft Shops, 14 F. Supp. 467, 469, "The preservation of business enterprises must not be at the expense of creditors, and the provisions of section 77B should not be taken advantage of to effect what, in fact, amounts to a composition under section 12."

The Chandler Act, c. 10 (52 Stat. 840) approved June 22, 1938, now supplants § 77B. Various substantial changes in the provisions of § 77B have been made therein. But the standard of "fair and equitable" as used in § 77B remains unaltered as one of the criteria necessary for confirmation of a plan of reorganization. § 221(2).

We come then to the legal question of whether the plan here in issue is fair and equitable within the meaning of that phrase as used in § 77B.

We do not believe it ~~was~~ is for the following reasons. Here the court made a finding that the debtor is insolvent not only in the equity sense but also in the bankruptcy sense. Admittedly there are assets not in excess of $900,000, while the claims of the bondholders for principal and interest are approximately $3,800,000. Hence even if all of the assets were turned over to the bondholders they would realize less than 25 per cent on their claims. Yet in spite of this fact they will be required under the plan to surrender to the stockholders 23 per cent of the value of the enterprise.

True, the relative priorities of the bondholders and the old Class A stockholders are maintained by virtue of the priorities accorded the preferred stock which the bondholders are to receive. But this is not compliance with the principle expressed in *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra,* that "to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation", for there are not sufficient assets to pay the bondholders the amount of their claims. Nor does this plan recognize the "equitable right" of the bondholders "to be preferred to stockholders against the full value of all property belonging to the debtor corporation", within the meaning of the rule announced in that case, since the full value of that property is not first applied to claims of the bondholders before the stockholders are allowed to participate. Rather it is partially diverted for the benefit of the stockholders even though the bondholders would obtain less than 25% payment if they received it all. Under that theory all classes of security holders could be perpetuated in the new company even though the assets were insufficient to pay—in new bonds or stock—the amount owing senior creditors. Such a result is not tenable.

It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor. This Court, as we have seen, indicated as much in *Northern Pacific Railway Co.* v. *Boyd, supra,* and *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra.* Especially in the latter case did this Court stress the necessity, at times, of seeking new money "essential to the success of the undertaking"

from the old stockholders.[15] Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made. But if these conditions are not satisfied the stockholder's participation would run afoul of the ruling of this Court in *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co., supra*, that "Whenever assessments are demanded, they must be adjusted with the purpose of according to the creditor his full right of priority against the corporate assets, so far as possible in the existing circumstances" (p. 456). If, however, those conditions we have mentioned are satisfied, the creditor cannot complain that he is not accorded "his full right of priority against the corporate assets". If that were not the test, then the creditor's rights could be easily diluted by inadequate contributions by stockholders. To the extent of the inadequacy of their contributions the stockholders would be in precisely the position which this Court said in *Northern Pacific Railway Co.* v. *Boyd, supra*, the stockholders there were in, viz., "in the position of a mortgagor buying at his own sale" (p. 504).

In view of these considerations we believe that to accord "the creditor his full right of priority against the corporate assets" where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder.

The alleged consideration furnished by the stockholders in this case falls far short of meeting those requirements.

1. The findings below that participation by the old Class A stockholders will be beneficial to the bondholders because those stockholders have "financial standing and influence in the community" and can provide a "continuity of management" constitute no legal

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[15] This new money was commonly necessary in equity reorganizations not only to provide new working capital but also to pay dissenting creditors. See Weiner, Conflicting Functions of the Upset Price in a Corporate Reorganization, 27 Col. L. Rev. 132.

Like considerations are relevant in reorganizations under § 77B. As stated by the court in In re Dutch Wooderaft Shops, 14 F. Supp. 467, 471:

"Circumstances may exist where the success of an undertaking requires that new money be furnished and where the former stockholders are the only or most feasible source of the new capital. In such instances, the court may recognize as fair and equitable a plan which includes contributions of new money by stockholders, provided it satisfactorily appears that full recognition has been given to the value of creditors' claims against the property."

justification for issuance of new stock to them. Such items are illustrative of a host of intangibles which, if recognized as adequate consideration for issuance of stock to valueless junior interests, would serve as easy evasions of the principle of full or absolute priority of *Northern Pacific Railway Co.* v. *Boyd, supra,* and related cases. Such items, on facts present here, are not adequate consideration for issuance of the stock in question. On the facts of this case they cannot possibly be translated into money's worth reasonably equivalent to the participation accorded the old stockholders. They have no place in the asset column of the balance sheet of the new company. They reflect merely vague hopes or possibilities.[16] As such, they cannot be the basis for issuance of stock to otherwise valueless interests. The rigorous standards of the absolute or full priority doctrine of the *Boyd* case will not permit valueless junior interests to perpetuate their position in an enterprise on such ephemeral grounds.[17]

2. The District Court's further finding that if the bondholders were to foreclose now they would receive "substantially less than the present appraised value" of the assets of the debtor corporation is no support for inclusion of the old stockholders in the plan. The fact that bondholders might fare worse as a result of a foreclosure and liquidation than they would by taking a debtor's plan under § 77B can have no relevant bearing on whether a proposed plan is "fair and equitable" under that section. Submission to coercion is not the application of "fair and equitable" standards. Such a proposition would not only drastically impair the standards of "fair and equitable" as used in § 77B; it would pervert the function of that Act. One of the purposes of § 77B was to avoid

[16] On comparable facts a like conclusion was reached in In re Barclay Park Corp., 90 F. (2d) 595, where the court said, p. 598:

"It is argued that the stockholders represent the present management of the hotel and that the management is valuable and indeed necessary to the enterprise and that the manager-stockholders will 'walk out' if the proposed plan does not go through and leave the hotel to its fate. But there is no binding agreement on their part to remain which might afford a justification for giving them a stock interest and, if their managerial skill is vital to the success of the hotel, any stock issued to insure the continuance of their relation ought to go to those stockholders who are of use to the enterprise and agree to act in its behalf, and not to all stockholders as such. Indeed, the supposed advantages of retaining the existing management seem to be a matter of inference, if not of speculation, supported by the oral statements of attorneys instead of by testimony."

[17] This conclusion is reemphasized here by the fact that not all of the Class A stockholders who receive new stock are part of the management of the debtor.

the consequences to debtors and creditors of foreclosures, liquidations, and forced sales with their drastic deflationary effects.[18] To hold that in a § 77B reorganization creditors of a hopelessly insolvent debtor may be forced to share the already insufficient assets with stockholders because apart from rehabilitation under that section they would suffer a worse fate, would disregard the standards of "fair and equitable"; and would result in impairment of the Act to the extent that it restored some of the conditions which the Congress sought to ameliorate by that remedial legislation.

3. The conclusion of the District Court that the virtual abrogation of the agreement deferring foreclosure until 1944 ("the principal valuable consideration" given to the bondholders by the stockholders) justified participation by the stockholders in the plan is likewise erroneous.

What were the rights of the bondholders under the supplemental indenture executed in 1930 we cannot determine. That indenture is not in the abbreviated record before us. The District Court found that for all practical purposes the bondholders could not foreclose until 1944. From the findings below we conclude that that followed as a consequence of making interest payable only if earned. On this record it does not appear whether or not there might be other events of default—such as non-payment of sinking funds—giving bondholders or the trustee the right to foreclose or giving bondholders or the trustee the right to accelerate the maturity of the bonds so that suits could be brought thereon. Hence, we must assume, as the District Court found, that the bondholders and the trustee could not take possession of the property through foreclosure or otherwise until the maturity of the bonds. And as a corollary thereof we likewise assume that the stockholders, at least so far as the bondholders were involved, could keep their management group in possession and control until that time. And we assume that this right or power on the part of the stockholders to keep possession until 1944 was for them a thing of value, though there is no finding that the old stock had any value, present or prospective.

But we cannot conclude that that right survived the commencement of the proceedings under § 77B. A debtor as well as a creditor who invokes the aid of the federal courts in reorganization or rehabilitation under § 77B assumes all of the consequences which flow from that jurisdiction. Once the property is in the hands of

[18] See H. R. Rep. No. 1409, 75th Cong., 1st Sess., p. 38, dealing with recent amendments to the section; and H. R. Rep. No. 194, 73rd Cong., 1st Sess., p. 2, the report accompanying the original Act.

the court private rights as respect that *res* are subject to the superior dominion of the court and are to be adjudicated pursuant to the standards prescribed by the Congress. As a result of such proceedings the hand of all executions or levies may be stayed.[19] The court acquires "exclusive jurisdiction of the debtor and its property wherever located for the purposes of this section."[20] The court need not keep the debtor in possession but may substitute for the old management a trustee; or if the old management is retained it operates the business "subject at all times to the control of the judge, and to such limitations, restrictions, terms, and conditions as the judge may from time to time impose and prescribe".[21] Thus, while the property remains in the hands of the court, as it does until dismissal or final decree on confirmation, the debtor, though left in possession by the judge, does not operate it, as it did before the filing of the petition, unfettered and without restraint. The control of the court is then pervasive.[22] Furthermore stockholders and other junior interests may be excluded from any plan of reorganization if the court finds that the debtor is insolvent. *In re 620 Church Street Building Corp.*, 299 U. S. 24. And on facts such as exist here, these junior interests must be excluded unless they furnish adequate consideration for the interest which

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19 Section 77B(a), (c)(10) Cf. Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co., 294 U. S. 648.

20 Section 77B(a).

21 Section 77B (c).

22 See, 1 Gerdes on Corporate Reorganizations, c. 9. These powers embrace not only the specifically enumerated powers contained in § 77B but also "all the powers, not inconsistent with this section, which a Federal court would have had it appointed a receiver in equity of the property of the debtor by reason of its inability to pay its debts as they mature." § 77B(a). In addition, by virtue of § 77A the district court, as a court of bankruptcy, has original jurisdiction in proceedings under § 77B. Illustrative of specific powers granted by § 77B are the powers of the court to authorize issuance of certificates (§ 77B (c)(3)), to require the filing of schedules and reports (§ 77B (c)(4)), to direct rejection of executory contracts (§ 77B (c)(5)), to control salaries of officers and to approve appointments "to any office" (§ 77B(c)). The last subsection also provides, "In case a trustee is not appointed, the debtor shall continue in the possession of its property, and, if authorized by the judge, shall operate the business thereof during such period, fixed or indefinite, as the judge may from time to time prescribe, and shall have all the title to and shall exercise, consistently with the provisions of this section, all the powers of a trustee appointed pursuant to this section, subject at all times to the control of the judge, and to such limitations, restrictions, terms, and conditions as the judge may from time to time impose and prescribe." In the instant case the court left the debtor in possession, allowing its officers no salaries but allowing specified salaries to be paid to designated officers of the principal subsidiary.

they obtain in the new company. And once the jurisdiction of the court has been invoked, whether by the debtor or by a creditor, that petitioner cannot withdraw and oust the court of jurisdiction.[23] He invokes that jurisdiction risking all of the disadvantages which may flow to him as a consequence, as well as gaining all of the benefits. One of those disadvantages from the viewpoint of the debtor and its stockholders is the approval of a plan of reorganization which eliminates them completely.[24] Accordingly, respondent's assertion in this case that the major contribution of these stockholders justifying their inclusion in the plan was the waiver of their right to defer or put off foreclosure until 1944, i.e., to remain in possession, does not stand analysis. The right to remain in unmolested dominion and control over the property was necessarily waived or abandoned on invoking the jurisdiction of the federal courts in these proceedings. When that jurisdiction attached, the court rather than the stockholders was in control with all of the powers and duties which that entailed under § 77B. Certainly the surrender of a right thus waived is not adequate consideration for the dilution of the bondholders' priorities which this plan would effect.

And there is a further reason why this result necessarily follows, if the will of the Congress as expressed in § 77B is not to be thwarted and if the integrity of such proceedings is to be maintained. As we have said, this plan had its origin in an endeavor on the part of the debtor in 1937 to effect a voluntary reorganization. A plan was proposed by the debtor which was the same as that here involved except for the amount and nature of the stock to be received by the bondholders.[25] That plan contained two methods for its consummation. The first was by means of an amendment to the trust indenture and a recapitalization of the debtor, a method to be followed if the board felt that sufficient approvals had been obtained. The second was by means of § 77B.

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[23] The Act has explicit standards for dismissal (§ 77B (c)(8)) which we discuss hereafter.

[24] As recognized in In re 620 Church Street Building Corp., *supra*, § 77B (c)(1) expressly takes care of this contingency in the provision that acceptance of the plan by a majority of the stock "shall not be requisite to the confirmation of the plan by any stockholder or class of stockholders (1) if the judge shall have determined" inter alia, that "the debtor is insolvent."

[25] Under that plan the new company was to have an authorized capital of $1,000,000 consisting of 1,000,000 shares of a par value of $1.00 per share, the bondholders getting 590,065 of the shares and the old Class A stockholders getting 239,935 of the shares. Shares going to the bondholders were of the same class as those received by stockholders.

Over 80% of the bondholders and over 90% of the stock approved the original plan. Thereupon the debtor filed its petition in § 77B. Thereafter, the debtor filed a modification of the plan to which the assents, here relied upon, were obtained.[26] Thus respondent argues that since the plan of reorganization was entered into between the bondholders and the stockholders before institution of the reorganization proceedings under § 77B, the consideration flowing from the stockholders had been furnished and the interests of the bondholders and stockholders in the assets of the debtor had been fixed prior to the filing of the petition. In fact, respondent frankly insists that the stockholders' "right of participation was secured by contract before, and as a condition precedent to, the institution of the 77B proceedings."

But the mere statement of this proposition is its own refutation. If the reorganization court were bound by such conventions of the parties, it would be effectively ousted of important duties which the Act places on it. Federal courts acting under § 77B would be required to place their imprimatur on plans of reorganization which disposed of the assets of a company not in accord with the standards of "fair and equitable" but in compliance with agreements which the required percentages of security holders had previously made. Such procedure would deprive scattered and unorganized security holders of the protection which the Congress had provided them under § 77B. The scope of the duties and powers of the Court would be delimited by the bargain which reorganizers had been able to make with security holders before they asked the intercession of the court in effectuating their plan. Minorities would have their fate decided not by the court in application of the law of the land as prescribed in § 77B, but by the forces utilized by reorganizers in prescribing the conditions precedent on which the benefits of the statute could be obtained. No conditions precedent to enjoyment of the benefits of § 77B can be provided except by the Congress. To hold otherwise would be to allow reorganizers to rewrite it so as to best serve their own ends.[27]

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[26] These assents were apparently measured by the failure of the bondholders to withdraw their consents which had been given to the original plan, on receiving copies of the proposed modification.

[27] Cf. Hollister v. Stewart, 111 N. Y. 644, where the court struck down a voluntary reorganization which attempted to bind minority bondholders. The court said "Unless railroad syndicates or committees are to be put above the Constitution, the trustees cannot set aside and change their contract with plaintiff, of their own volition, without his consent." (p. 660.)

4. The holding of the District Court that the value to the bondholders of maintaining the debtor as a going concern and of avoiding litigation with the old stockholders justifies the inclusion of the latter in the plan is likewise erroneous. The conclusion of the District Court that avoidance of litigation with the stockholders gave validity to their claim for recognition in the plan involves a misconception of the duties and responsibilities of the court in these proceedings. Whatever might be the strategic or nuisance value of such parties outside of § 77B is irrelevant to the duties of the court in confirming or disapproving a plan under that section. In these proceedings there is no occasion for the court to yield to such pressures. If the priorities of creditors which the law protects are not to be diluted, it is the clear duty of the court to resist all such assertions. Of course, this is not to intimate that compromise of claims is not allowable under § 77B. There frequently will be situations involving conflicting claims to specific assets which may, in the discretion of the court, be more wisely settled by compromise rather than by litigation. Thus, ambiguities in the wording of two indentures may make plausible the claim of one class of creditors to an exclusive or prior right to certain assets as against the other class in spite of the fact that the latter's claim flows from a first mortgage.[28] Close questions of interpretations of after-acquired property clauses in mortgages, preferences in stock certificates, divisional mortgages and the like will give rise to honest doubts as to which security holders have first claim to certain assets. Settlement of such conflicting claims to the *res* in the possession of the court is a normal part of the process of reorganization. In sanctioning such settlements the court is not bowing to nuisance claims; it is administering the proceedings in an economical and practical manner. But that is not the situation here. As a result of the filing of the petition in this case, the court, not the stockholders, acquired exclusive dominion and control over the estate. Hence, any strategic position occupied by the stockholders prior to these proceedings vanished once the court invoked

[28] That would appear to be essentially the type of case involved in In the Matter of Detroit International Bridge Co., Debtor, No. 24131, U. S. D. C. E. D. Mich., cited to us by the respondent and described in an advisory report (Corporate Reorganization Release No. 9) submitted by the Securities and Exchange Commission pursuant to § 172, c. X of the Chandler Act. However, the action of the court, if any, on the plan has not yet appeared in the published reports.

its jurisdiction. Threats by stockholders of the kind here in question are merely threats to the jurisdiction of the court, which jurisdiction these selfsame stockholders invoked for their benefit when they caused the debtor's petition to be filed. Consequently, these claims of the stockholders are, as we have said, entitled to no more dignity than any claim based upon sheer nuisance value.

In this connection it should be observed that the finding of the court that it was important to admit the stockholders to participation in the plan so as to maintain the debtor as a going concern and thus protect the bondholders was based upon a misconception of its legal powers and duties. For the court assumed that the only alternative to acceptance of this debtor's plan was a dismissal of the proceeding or a liquidation. But this is not true. In the first place, no special perquisites (of consequence here) flow to stockholders by virtue of the fact that the proceedings are instituted by a voluntary rather than an involuntary petition. The criteria for exclusion or inclusion of stockholders in a plan are precisely the same in both situations. In practice it is not infrequent to find proceedings which start with a debtor's petition ending up with plans of reorganization which exclude stockholders. *In re Reading Hotel Corp.*, 89 F. (2d) 53. In the second place, failure to accept this plan does not force dismissal or liquidation. Section 77B(c)(8) gives the court explicit powers where "a plan of reorganization is not proposed or accepted within such reasonable period as the judge may fix" either to "extend such period" or to "dismiss the proceeding" or, with exceptions not relevant here, to cause liquidation, such choice to be made "as the interests of the creditors and stockholders may equitably require". Accordingly, dismissal has not infrequently been properly denied. *In re Bush Terminal Co.*, 84 F. (2d) 984. And in this case there has been no showing that a plan which is not only fair and equitable but also meets the other requirements of the Act cannot be adopted nor that all reasonable time for proposal of such alternative plans has expired.

We therefore hold that the plan is not fair and equitable and that the judgment below must be and is

Reversed.

Mr. Justice BUTLER took no part in the consideration or disposition of this case.